SAUDI ARABIA: THE DUALITY OF THE LEGAL SYSTEM AND ITS IMPLICATIONS ON FINANCIAL RELATED TRANSACTIONS

A Thesis Submitted in Fulfilment of the Requirement for the Degree of Doctor of Philosophy in Law

SUBMITTED BY: AMR DAOUD MARAR
LL.M (Distinction)(Essex), PhD Candidate (Lond)

SUPERVISED BY: PROF. JOSEPH NORTON
SJD., DPhil., LLD(Lond), LLD(hc)(Stockh.)

Centre for Commercial Law Studies

Queen Mary & Westfield College

University of London

ABSTRACT

Saudi Arabia is moving towards a "free market" economy. This policy shift is consistent with the prevailing developmental views of the major international financial and economic institutions and of the major industrialised nations (which will form a given assumption for this thesis). A companion policy assumption fostered today by the international financial institutions and major industrialised nations is that essential to a sound market economy is a viable *rule-based* legal infrastructure that incorporates a substantive and procedural "rule of law" orientation.

The recent economic legal reforms being undertaken by Saudi Arabia involve both enhancements and modifications to the basic Islamic law framework required under the Saudi Constitution to help facilitate the growing domestic demands of the Saudi economy and society and the *de facto* introduction of "modern" Western-based practices, approaches and techniques respecting commercial and financial transactions. That would be more attractive to foreign investors and financiers. While such reforms should make a positive contribution to the development of the desired market-based system, the overall effectiveness of these new reforms, as argued in this volume, may be adversely impacted or impeded by the *existing de facto duality* created by these reforms. This *existing de facto duality* is exemplified by having Islamic law (*i.e., Shari'a*) as the paramount and primary legal system and, within this overall system, the separate, enactment of other positive laws related to the commercial, banking and financial sectors (*i.e.*, "a system *within* a system").

This thesis argues that this current Saudi notion of legal *duality* needs to be re-evaluated and an internal reconciliation needs to be effected to avoid any negative implications on the functionality of the financial system and on the effectiveness of financial transactions such as, merely by way of selective example used in this volume, securitisations and secured transactions, which are important elements in a "modern" market-based economy. To this effect, Saudi Arabia may consider the advisability of further *dualising* the Saudi financial system whereby the "Western-based" component of the Saudi financial system is not functioning *within* an Islamic *Shari'a* system but *alongside* an Islamic financial system (*i.e.*, a system *alongside* a system) as is the case in a successful emerging economy such as Malaysia. In doing

so, Saudi Arabia is also advised to consider the "segregation" phenomenon, which is used in the Dubai International Financial Centre (DIFC), to segregate its conventional financial component from any inconsistencies with other Saudi laws.

It is suggested that the Saudi government in implementing a combination of the Malaysian and DIFC models can better develop a complementary and reinforcing *dual* "parallel" financial system structure of a modern Western-oriented system and a modernised Islamic financial system, with both operating legitimately under the "umbrella" of an Islamic grounded Constitution. In effect, a *dual* financial system should provide an opportunity for the Saudi government to have the better of both worlds: a special and robust financial system that is well-rooted in the domestic culture and interconnected with the growing Islamic regional financial markets in the Gulf Region and that also makes foreign investment and financing in Saudi Arabia and the Region more attractive and "secure" while making it feasible to link it into the broader "global" international financial markets.

CONTENTS

INTRODUCTION

Adopting a *market-based economy* or the move towards such policy is thought to make a positive contribution to the cause of economic development and modernisation.[1] Hence, many countries and governments, especially after the demise of the Soviet-Union and its alternative centrally-planned are adopting market economic policies.[2] The main reason for this policy shift is the urgent domestic need for economic development by developing countries in improving the living standards and the economic infrastructure.

Also, *globalisation* has played an important role or is being seen as a reason for adopting market-oriented policies.[3] Globalisation is the result of the profound transformation which the world order is undergoing as exemplified by the improvement of technology that facilitate the movement of people and lead to the fast transmission of capital, goods and economic and political ideas globally. Connected to this global integration is the dominance of the 'neo-liberal policy convergence', which is a "policy shift among states towards an open, market-oriented policy stance".[4]

At the heart of these market-economy policies and changes, which aim for sustainable economic growth and equitable wealth creation, financial systems play a pivotal role. Capital formation is perceived as an important element for

[1] *See* THE INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT: WORLD DEVELOPMENT REPORT 1996: FROM PLAN TO MARKET (Oxford University Press, 1996). *See also,* THE STATE IN A CHANGING WORLD: WORLD DEVELOPMENT REPORT (Oxford University Press, 1997). *See also* the World Bank's website "Legal Institutions of the Market Economy"; http://www1.worldbank.org/publicsector/legal /index.cfm

[2] *See, e.g.*, the East European countries which adopted market economic policies. For more details, *see* PAUL MARER ET AL., THE TRANSITION TO A MARKET ECONOMY: Volumes (1)&(2), (OCDE, 1991).

[3] Gunther Schulze et al., *Globalisation of the Economy and the Nation State*, 22(3) THE WORLD ECONOMY 295, at 303, (1999).

[4] KATHERINE LYNCH, THE FORCES OF ECONOMIC GLOBALISATION: CHALLENGES TO THE REGIME OF INTERNATIONAL COMMERCIAL ARBITRATION , at 46 (Kluwer Law International, 2003),

development.[5] Extension of credit is an "engine of economic growth".[6] Any development projects to improve the economy, job creation, improvement of the economic infrastructure and so on in any country require capital. Unavailability of the needed capital to undertake these development changes necessitates creation of, or deepening of, the existing financial system to facilitate the accumulation of capital and the productive channelling of funds domestically. This, in turn, would need an improved and developed legal infrastructure to facilitate the orderly and transparent functioning of the financial system. Such will be needed to attract external funds and capital.

The law plays an important role as an instrument to achieve a country's economic goals.[7] All economic policies would prove fruitless if they operate in a legal vacuum or within a legal system that does not accommodate these economic changes or is inconsistent with their application. To meet a country's development needs and to accommodate any new economic policy, legal reforms are important to facilitate effectively the implementation of this economic policy. In the light of this, market-

[5] *See* NEAL ZANK ET AL., REFORMING FINANCIAL SYSTEMS: POLICY CHANGE AND PRIVATISATION, at 1 (Greenwood Press, 1991): "One of the primary constraints to accelerated economic performance in developing countries is the absence of strong, dynamic financial systems. Healthy capital and credit markets can serve the vital functions of attracting savings, intermediating funds, and allocating credit to productive uses. Development practitioners are unanimous in their identification of capital formation as one of the most important components in the development process".

[6] Neil Cohen, *Internationalising the Law of Secured Credit: Perspectives from the U.S Experience*, 20(3), U. PA. J. INT'L ECON. L., 423, (1999), 428.

[7] It is submitted that the law is used as an instrument for economic reform. *See* JOSEPH NORTON, FINANCIAL SECTOR LAW REFORM IN EMERGING ECONOMICS, at 129 (The British Institute of International and Comparative Law and The London Institute of International Banking, Finance and Development Law Limited, 2000): "In terms of the legal content of the economic reform dimension of the transition to a market economy, the role of law should be seen, on the one hand, as a means or instrument for implementing effective and efficient policies". *See also* BAHHA EL-DEAN, PRIVATISATION AND THE CREATION OF A MARKET-BASED LEGAL SYSTEM: THE CASE OF EGYPT, at 4 (Koninklijke Brill NV, 2002): "The inter-relationship between law and economic policy is apparent. Law in any given state, of whatever economic policy, do not function in isolation; they are inter-related with and at the same time reflect the state's economic and political ideology. As law is the principal instrument used by governments to translate policies into binding rules, governments resort to legislation whenever they wish to influence behaviour, conditions, or events".

economy necessitates a market-oriented legal framework within which market forces would be able to function in an effective, transparent and fair manners.

In the light of this, there have been economic and financial reforms in many parts of the world. These reforms have encompassed legal reforms to facilitate implementing the new economic policies and to increase the investors' confidence in the legal system to encourage investments. Islamic countries are no exception. Many Islamic countries have been involved recently in major reforms to their economic, financial and legal systems to keep up to speed with global economy and to accelerate economic development domestically.

However, certain Islamic countries have been experiencing difficulties in adapting to market-economy. This is particularly true in the case of financial services that Islamic countries have always viewed them as being against the Islamic *Shari'a* for reasons that will be explained in Chapter One. Due to the difficulties associated with the financial services, certain Islamic countries have developed Islamic-complaint financial services, the co-called "Islamic finance". "Islamic finance" has been expanding successfully in recent years and many Islamic countries have recognised "Islamic finance" and adopted it alongside its non-Islamic financial system.

Amidst all these developments that the world has been witnessing, the Kingdom of Saudi Arabia is attempting to develop and to improve its financial and legal systems. To this effect, Saudi Arabia has been undertaking recently major reforms to its financial and legal systems. Most importantly, Saudi Arabia has introduced a law to supervise the activities of its capital market and it has transformed its insurance sector to an Islamic-compliant insurance system. This volume aims to study the case of Saudi Arabia and track the current tensions arising from adapting the Saudi legal system, being Islamic *Shari'a*, with global economy. It provides insights towards further developing the Saudi would-be market-led financial system in the light of other models adopted by certain Islamic countries including regional and international developments.

CHAPTER ONE

THE DEVELOPING COUNTRIES IN GLOBAL ECONOMY AND THE LEGAL IMPLICATIONS: THE CASE OF THE ISLAMIC COUNTRIES

CHAPTER OUTLINE

1. INTRODUCTION

In moving towards a market-oriented economy, virtually; every developing country is undergoing some form of financial sector law reform.[1] In doing so, a major or a would-be concern to a developing country, at certain stage of its economic development, is the linkages to the global markets. Such linkage would secure an access to the international financial markets and in return would enhance the developing country's domestic financial market. It would also attract foreign investments and facilitate capital flow to the developing country.

To this effect, developing countries, with varying extents, attempt to join global economy through implementing the policies and views of the major international economic and financial institutions such as the International Monetary Fund (IMF),[2] the International Bank for Reconstruction and Development (World Bank),[3] and the Organisation for Economic Co-operation and Development (OCED).[4] Equally, these policies and views are reflected in the creation of certain regional trade agreements and multilateral institutions such as the European Union (E.U),[5] North American Free Trade Agreement (NAFTA),[6] Mercosur,[7] the Co-operation Council for the Arab States of the Gulf (G.C.C)[8], the World Trade Organisation (WTO)[9] and the major industrialised nations through the G-7/G-8.[10]

The developmental policies and views being propagated by these bodies and governments, which would serve as suitable starting points and are chosen as

[1] JOSEPH NORTON, FINANCIAL SECTOR LAW REFORM IN EMERGING ECONOMIES, at 2 (BIICL, 2000).
[2] *See generally* http://www.imf.org
[3] *See generally* http://www.worldbank.org
[4] *See generally* http://www.oecd.org
[5] *See generally* http://europa.eu/
[6] *See generally* http://www.nafta-sec-alena.org
[7] *See generally* http://www.mercosur.int
[8] *See generally* http:// www.gcc-sg.org/
[9] *See generally* http://www.wto.org
[10] *See generally* http://www.g7.utoronto.ca/

fundamental assumptions for the purposes of this thesis,[11] include the following: 1) a sustainable economic development requires a shift from centralised to a market economy, 2) a sound market economy requires an appropriate *rule-based* economic and financial legal infrastructures; 3) such a viable legal infrastructure requires a genuine procedural and substantive *rule of law* orientation. Additionally, at the *micro* level, these requirements translate into market-oriented laws that facilitate the activities of a market economy including financial transactions.

In incorporating the above policies, developing countries are facing the challenge of adapting these market-oriented policies and laws to their domestic legal systems. Failure to do so, may result of a certain form of legal pluralism that contains inconsistent laws and in turn adversely affect the economy.[12] Douglas writes:

"In countries where the legal reform process has permitted customary laws to exist side by side with new laws..., the potential for legal conflict between the customary laws and the new formal system adds yet another dimension of uncertainty to the functioning of the economy".[13]

Moving from general to particular, the Arab and Islamic countries, especially the Kingdom of Saudi Arabia, are among those countries that have been undergoing market-oriented reforms to join more closely the global economy. In doing so, these countries, including Saudi Arabia, are or have been in the process of modernising their economies, financial infrastructures and legal systems.

[11] This Chapter is not intended to argue the merits of such assumptions as conclusive and exclusive policy objectives. However, this Chapter does attempt to set forth the historical, institutional, and policy bases for such prevailing assumptions and in the modern *genre* of economic developmental law theories and polices.

[12] As will be argued in this thesis, not all forms of legal pluralism have adverse impact on its market-oriented economic policies. *See* discussion *infra*.

[13] Douglas Webb, *Legal System Reform and Private Sector Development in Developing Countries, in* Economic Development, Foreign Investment and the Law: Issues of Private Sector INVOLVEMENT, FOREIGN INVESTMENT AND THE RULE OF LAW IN A NEW ERA, 47 (Robert Pritchard, ed., Kluwer Law International and International Bar Association, 1996).

To this effect, certain Islamic countries, including Saudi Arabia, were enticed to examine other financial and legal models that have been adopted internationally or by developed countries to accelerate the transformation process and to achieve the desired aims. In fact, borrowing other countries' models is not a recent phenomenon in the Arab and Islamic countries. For example, Islamic countries had to live with Western-based interest-bearing financial systems and practices (referred to as *conventional* financial system henceforth) for decades.[14]

Nevertheless, the presence of conventional financial systems and its associated legal practices in the Islamic countries has generated many legal issues and debates in respect to their inconsistency with the principles of Islamic *Shari'a*. Islamic *Shari'a* being the paramount legal system of certain Islamic countries such as Saudi Arabia, or one of the principal law sources in most Islamic countries' constitutions considers conventional financial systems and practices as illegitimate as will be explained later in this Chapter.

As a result, Islamic countries have been experiencing certain difficulties in accommodating conventional financial systems and practices. This unease and the persistent "legal unrest" resulting from the conflict between Islamic *Shari'a* and modern finance have induced the Islamic countries to devise certain models and legal innovations to "stabilise" this "legal unrest". These innovations have been recognised by certain Islamic countries in order to provide a functional equivalent for an efficient market-led financial system.

Thus, Islamic countries were able to develop an Islamic-compliant financial model, such as in Malaysia that can to some extent meet modern financing needs and

[14] For the purposes of this thesis, the term "conventional" would mean any financial transactions that involve interest payment. *See also* the discussion *infra*.

at the same time fulfil the requirements of Islamic *Shari'a*. In addition, certain countries in realising the fact that their domestic legal systems might jeopardise the activities of the would-be "international" financial centres, have adopted the "segregation" phenomenon whereby the legal framework of the financial centre is completely *segregated* from the country's own legal system. A good example is the Dubai International Financial Centre (DIFC)[15] through which the "segregation" phenomenon has been first initiated.

This Chapter aims to lay down the foundations upon which the legal and financial systems of Saudi Arabia are discussed throughout this volume. In doing so, the trends of global economy are the main departure points.[16] Then, a discussion of the "legal pluralism" concept is necessary to provide a helpful background for further discussions of certain legal and financial models that are existing (*i.e.*, Saudi Arabia), have developed (*i.e.*, Malaysia and DIFC) or can be developed[17] in the Islamic countries. Finally, the Chapter focuses on the Islamic countries *vis-à-vis* the trends of global economy highlighting their implications and the resulting "legal pluralism" models as well as the emerging concept of "Islamic finance".

2. TRENDS OF GLOBAL ECONOMY

2.1 THE POLICY SHIFT TOWARDS MARKET ECONOMY

One of the main features in the developing countries is the predominant role of the public sector in the production structure.[18] One of the reasons for the public sector's

[15] *See generally* http://www.difc.ae
[16] As already mentioned, these trends namely; market economy, rule-based financial systems and the "rule of law" are considered as given assumptions for the purposes of this thesis.
[17] A combination of the Malaysian model and the DIFC is suggested for the case of Saudi Arabia. *See* Chapter Five.
[18] Said El-Naggar, *Privatisation and Structural Adjustment: The Basic Issues*, *in* PRIVATISATION AND STRUCTURAL ADJUSTMENT IN THE ARAB COUNTRIES, at 1. (Said El-Naggar ed., International Monetary Fund, 1989).

dominance in these countries is often the result of a political ideology for countries that have passed through a stage of socialist development.[19] Another reason for the public dominance is for pragmatic considerations:[20] for example, governments may have had to intervene in the *means* of production or in providing the services[21] for a variety of *bona fide* reasons.[22] However, regardless of the reasons of adopting these policies, the developing countries believed that such polices are a step towards economic development and modernisation. Evidently, the dominance of the public sector and the adoption of these policies to modernise and to develop the country have proved to be unsatisfactory.[23] These unsatisfactory achievements that resulted from adopting these policies have encouraged the developing countries to seek alternative models.

At this juncture, the model of a *market-based economy* appears to provide an alternative solution. Hence, many developing countries have begun to go in the opposite direction. Private sector involvement in the economy is encouraged and begins to displace (but, not wholly) public sector dominance. A market economy, which can be defined as a "system of allocating resources based only on the interaction of market forces, such as supply and demand [and it is] free of governmental influence, collusion and other external interference",[24] starts to replace the "*command economy*" model and to become the driving force in allocating natural resources. Hence, the essence of market economy is to minimise to some extent the

[19] *Id.*
[20] *Id.* at 2.
[21] *Id.*
[22] *E.g.*, the desire to take control of strategic natural resources or unavailability of private sector to undertake important investments. *Id.*
[23] *Id.* El-Naggar, summarises the results of studies undertaken on the consequences of the dominance of the public sector in developing countries on the economy: "It was found that, with few exceptions, the public sector incurs substantial loss, contributes significantly to budget deficits, earns exceedingly low, even negative, rates of return, and has a negative impact on the balance of payment".
[24] *See* http://www.investorwords.com/2971/market_economy.html

influence of non-economic factors that could influence the allocation of resources efficiently.[25] This is in contrast with the "*command economy*" model in which most allocations occur as a result of a command issued by a central government agency.

While a market economy is usually connected to "capitalism" and Western economies, some argued that this is not necessarily the case (*e.g.*, the current stage of a "socialist market economy" in the People's Republic of China).[26] A market economy could exist with some levels of governmental interference depending on how this influence is used.[27] Regardless of whether a market economy is necessarily connected to a political ideology, market economy is viewed today as a necessary *means* for economic development. Recently, many countries have adopted the process of transformation to a market economy, especially after the demise of the Soviet Union.[28]

This policy shift towards a market-based economy is becoming a general trend. It is supported by the major international financial institutions and the international economic bodies, which seek to build a global economic order and to play a leading role in this transformation process. Also, other regional blocs such as the EU and the G.C.C support these policies. The desire of the developing countries to join this global economic order and their commitment for international integration depends on their willingness to undertake market-oriented reforms which meet the policies of these institutions, organisations and regional blocs. For example, the Central and

[25] Blommestein et al., *The Role of Financial Institutions in the Transition to a Market Economy* , *in* BUILDING SOUND FINANCE IN EMERGING MARKET ECONOMICS, 139, at 143 (Gerard Caprio et al. eds., International Monetary Fund, 1994).
[26] *Id.* There could be a 'socialist market economy', *see* LEGAL DEVELOPMENTS IN CHINA: MARKET ECONOMY AND LAW (Wang Guiguo et. al. ed., Sweet & Maxwell, 1996).
[27] *Supra* note 18.
[28] Jeswald Salacuse, *The Legal Architecture of Emerging Markets*, *in* THE REFORM OF THE INTERNATIONAL FINANCIAL ARCHITECTURE, 47, at 58. (Rosa Lastra ed., Kluwer Law International, 2001)(refers to the market economy model as 'Development Model II' and to the opposite economy model as 'Development Model I').

Eastern European Countries had to commit to undertake major economical reforms which meet the criteria of the EU in order to be able to join or associate with the EU. Also, applying for the membership in the WTO requires the applicant to undertake major changes to meet the WTO's criteria.

A good illustration is to consider the IMF and its leading role in assisting countries to move towards market-economy.[29] The IMF offers financial assistance for emerging markets that are IMF members in transition through its 'conditionality' policy.[30] Under this policy the IMF offers financial support to a specific country on the condition that this country undertakes market-oriented reforms alongside the financial assistance.[31]

The role of the IMF can be seen in the recent Asian financial crisis. During the Asian financial crisis in 1997/1998, the IMF provided financial assistance to Thailand, Korea and Indonesia. Under its 'conditionality' policy, the IMF required certain banking, financial and market-oriented reforms to be undertaken by the borrowing countries.[32] Likewise, the World Bank offers technical and financial assistance on the condition that certain financial, legal and market-oriented reforms are undertaken by the borrowing countries. The OCED share some overlap in the

[29] Rosa Lastra, *The International Monetary Fund in Historical Perspective*, 3(3) J. Int. Economic Law 507, 521, (2000).
[30] For a general study on the IMF conditionality policy see Ariel Buira, *'An Analysis of IMF Conditionality'*, G-24 Discussion Paper Series, No.22, 2003.
[31] The IMF will offer such technical assistance only when requested. Generally, when the financial assistance is requested by the borrower country, a letter of intent will be submitted to the IMF which outlines the reforms which the borrower country is willing to undertake. In theory, the programme of the reforms will be chosen by the borrower country but in practice the IMF does play a very influential role in designing these programmes. *See* Rosa Lastra, *'IMF Conditionality', in* INTERNATIONAL MONETARY AND FINANCIAL LAW UPON ENTERING THE NEW MILLENNIUM: SIR JOSEPH GOLD MEMORIAL SERIES VOL. 1, at 554 [hereinafter INTERNATIONAL MONETARY] (Joseph Norton and Mads Andenas eds., BIICL, 2002).
[32] On the Asian financial crisis see part two *The East Asian Financial Crisis: 1997- 1998, in* FINANCIAL CRISES IN THE 1990S: SIR JOSEPH GOLD MEMORIAL SERIES VOL. 4 (Douglas Arner et al. eds., BIICL, 2001).

mission of these institutions in promoting market-oriented policies. In fact, the fundamental criterion to join the OCED is being a market-based economy.[33]

Other regional development banks are playing a vital role in promoting market-oriented policies. For example, the purpose of establishing the European Bank for Reconstruction and Development (EBRD) is to stimulate the transition towards market economy. Article 1 of the EBRD Establishing Agreement provides: "In contributing to economic progress and reconstruction, the purpose of the Bank shall be to foster the transition towards open market-oriented economies and to promote private and entrepreneurial initiative in the Central and Eastern European countries committed to and applying the principles of multiparty democracy, pluralism and market economies".[34] To this end, the EBRD has been involved in market-oriented legal reforms in its countries of operation.[35]

The above institutions and organisations are working together and in co-operation with the industrialised states through the G-7/G-8 in promoting the move towards market economies.[36] Also, other developing countries through their regional blocs

[33] The OCED uses two criteria in considering the eligibility of the candidate country namely; "like-mindedness" and "significant player". Under the "like-mindedness" criteria there are several yardsticks; most fundamentally the existence of market-based economy and democratic principles. A third criterion could be considered namely; "mutual benefit". *See* A STRATEGY FOR ENLARGEMENT AND OUTREACH: REPORT BY THE CHAIR OF THE HEADS OF DELEGATION WORKING GROUP ON THE ENLARGEMENT STRATEGY AND OUTREACH, Ambassador Seiichiro Noboru (OECD), at 16-18.

[34] Article 1, *Agreement Establishing the European Bank for Reconstruction and Development, available at* http://www.ebrd.com

[35] The aim of the legal reforms undertaken by the EBRD was to "assist the Bank's countries of operations to develop a legal environment which supports the conduct of private sector commercial and financial transactions and assists in fostering the transition towards democratic, open market-oriented economies". *See* JOSEPH NORTON, *International Financial Institutions and the Movement toward Greater Accountability and the Case of Legal reform Programmes and the Problem of Evaluation, in* INTERNATIONAL MONETARY, *supra* note 31, at 388.

[36] *See* G8, FOSTERING GROWTH AND PROMOTING A RESPONSIBLE MARKET ECONOMY: A G8 DECLARATION, Evian, June 2 (2003), *available at* http://www.g7.utoronto.ca/summit/2003evian/growth_en.html. The G-7 comprises of USA, Japan, Germany, France, the UK, Italy and Canada. Also referred to as the G-8 with the inclusion of Russia. There are other groups or 'Gs' such as the G-10, G-20 and the G-22 which have been created at the initiatives of governments. These 'Gs' provide "a forum for developing a consensus on national policies needed for a robust international financial system and international understandings concerning the limits of these policies"; *see* Mario Giovanoli, *A New Architecture for the Global Financial Market: Legal Aspects of International*

have approved the move towards market economy as a basis for their regional integration efforts. The G.C.C in adopting the Long-Term Comprehensive Development Strategy for the G.C.C States (2000-2025) has approved the need to move towards a market-based economy.[37] Having argued that market-economy has become a global trend, it is helpful to identify the main characterises of such economy.

2.2 THE CHARACTERISTICS OF MARKET ECONOMY

Notwithstanding arguments concerning the ideological foundations of a particular country's economy, there are four common features of market economics.[38] Firstly, the state has a limited role in planning the economy or in allocating the society's resources. Unlike in a command economy, decisions on investments and credit allocations should be left primarily for the market to decide.[39] Market economy is a decentralised decision-making system.[40] Thus, there is no central governmental agency which informs the individual producer what to produce and how the production to be distributed.[41] However, we have to bear in mind that the role of the government is not wholly abolished in market economies.[42] For example, the government has to ensure effective competition which is a pre-requisite in market economies.[43]

Financial Standards Setting, in INTERNATIONAL MONETARY LAW: ISSUES FOR THE NEW MILLENNIUM, at 18 (Mario Giovanoli ed., Oxford University Press, 2000).

37 *See generally* CHAPTER TWO.

38 Salacuse, *supra* note 28, at 59.

39 *Id.*

40 ARNE. ISACHSEN ET AL., UNDERSTANDING THE MARKET ECONOMY, at 14 (Oxford University Press, 1992).

41 In a market economy the prices are the carriers of the information, *see Id.*

42 *Id*, at 128.

43 *Id. See also id.* Chapter 7 (Prerequisites for a Market Economy), at 77.

Secondly, private enterprises and private ownership are fundamentals.[44] As explained above, a command economy model is rooted in a public ownership of the country's resources, evincing "little confidence in the capacity of private initiative and the free market to do the job".[45] Hence, public enterprises carry out all sort of economic activities. In a market economy, however, private enterprises are a primary *means* for production. Thirdly, in a market economy system any excessive regulation should be removed; a process called 'deregulation'.[46] The private sector should not be constrained by regulations that impede it from active participation in the economy. The general rule should be that "all economic activity is permitted unless specifically prohibited".[47] Finally, in a market economy system there should be "economic liberalisation" by reducing the barriers to international and internal trade.[48] No excessive regulations should impede the inflow of foreign investment, technology and capital.

Governments that are willing to adopt the market economy model should ensure the existence of the abovementioned characteristics in their overall economic policies. This should be accompanied, however, with policies on macroeconomic

[44] Salacuse, *supra* note 28, at 59. However, privatisation is considered to be a means to the introduction of market economy. *See* PAUL MARER ET AL., THE TRANSITION TO A MARKET ECONOMY: Volume (2), at 14 – 15 (OCDE, 1991) ("privatisation forms a central pillar of the programme to create market economics.... Creating a market economy is thus seen as inextricably tied to the establishment of the institution of private property, and the privatisation of state assets.")
[45] EDWARD MASON, ECONOMIC PLANNING IN UNDERDEVELOPED AREAS: GOVERNMENT AND BUSINESS, at 43 (Fordham University Press, New York, 1958).
[46] Salacuse, *supra* note 28, at 60. It is submitted that under a market-economy and privatisation policies, the state's role in the economy changes from producer to regulator. This should not be confused with the 'deregulation' process. While the state should remove any excessive regulations, it should introduce some form of regulation to supervise the market. *See also* Ibrahim Shihata, *Good Governance and the Role of Law in Economic Development*, *in* MAKING DEVELOPMENT WORK: LEGISLATIVE REFORM FOR INSTITUTIONAL TRANSFORMATION AND GOOD GOVERNANCE, at xvii (Ann Seidman et al. eds., Kluwer Law International, 1999).
[47] *See Salacuse*, at 61. This general rule has been referred to as the 'presumption of permissiveness'. *See Shihata* explains the assumption: "The assumption, however, should always be that economic activities are generally permitted, subject only to the legal and regulatory requirements which should be kept to the minimum needed to serve their purpose".
[48] *See Salacuse*.

stability, a sound currency, fair competition,[49] and an efficient financial intermediation system.[50] Due to the particular importance of financial systems, for the purposes of this volume, the following section will discuss this in further detail.

2.3 THE IMPORTANCE OF A RULE-BASED FINANCIAL SYSTEM

The availability of a strong and efficient financial system is at the heart of the transformation from command economy to a market economy.[51] As noted above, in a command economy model, allocation of resources is controlled mainly by a central plan.[52] Theoretically, once there is a transformation from a command economy model to a market economy one, and the central planning is abolished a "vacuum" emerges.[53] Hence, it becomes essential to establish the necessary conditions "under which lending is rationed by price and constrained by borrowers' solvency- that is, that there should be sound, market-based finance".[54] Thus, financial systems play a very important intermediation role in market economies, facilitating the move of funds and the provision of credit to finance projects and to stimulate the "privatisation" process.[55]

---

[49] Michel Herbiet, *The Constitutional Basis of the Economic Order During a Period of Transition from a Planned Economy to a Market Economy*, *in* RULE OF LAW AND TRANSITION TO A MARKET ECONOMY: PROCEEDINGS OF THE UNIDEM SEMINAR ORGANISED IN SOFIA ON 14-16 OCTOBER 1993, at 15 (European Commission for Democracy through Law, Council of Europe Press, 1994): "Another basis of the market economy certainly appears to be the principle of free competition which allows the various economic operators to pursue their economic activities in ' a system of competition which must not be hindered by either regulations or by benefits coming from the public authorities'".

[50] PAUL MARER ET AL., THE TRANSITION TO A MARKET ECONOMY: Volumes (1), at 111 (OCDE, 1991).

[51] G. CAPRIO ET AL., BUILDING SOUND FINANCE IN EMERGING MARKET ECONOMICS: PROCEEDING OF A CONFERENCE HELD IN WASHINGTON, D.C. JUNE 10-11, 1993, at 1 (International Monetary Fund, 1994).

[52] *Id.*

[53] *Id.*

[54] *Id.*

[55] *See* SUSAN CREANE ET AL., FINANCIAL DEVELOPMENT IN THE MIDDLE EAST AND NORTH AFRICA, at 2 (International Monetary Fund, 2003): "A modern financial system promotes investment by identifying and funding good business opportunities; mobilises savings; monitors the performance of managers; enables trading' hedging and diversification of risk; and facilitates the exchange of goods and services. These functions result in a more efficient allocation of resources, a more rapid

More specifically, as fostered by the international financial and economic institutions and other regional development banks, a *robust* rule-based financial system is essential to a market economy; that is, one that meets the "test of markets".[56] Thus, it remains stable despite the market conditions and circumstances.[57] The *robustness* of the financial system is considered to be a fundamental factor for financial stability.[58] The robustness is exemplified by the flexibility of the financial system and its internal stability.[59] Hence, despite the economic changing circumstances, a *robust* financial system should continue to function efficiently in allocating resources and it will not generate financial shocks of a magnitude that can lead to a financial crisis.[60]

Due to the importance of a robust financial system to exist, the G-10 has identified three actions to be taken by each country in relation to its financial system depending on its development stage: these are 1) creation of an institutional setting and financial infrastructure necessary for a sound credit culture and effective market functioning; 2) promotion of the functioning of markets so that owners, directors, investors and other actual and potential stakeholders exercise adequate discipline over financial institutions; and 3) creation of regulatory and supervisory arrangements that complement and support the operation of market discipline.[61]

accumulation of physical and human capital, and faster technological progress, which in turn feed economic growth".

[56] REPORT OF THE G10 WORKING PARTY ON FINANCIAL STABILITY IN EMERGING MARKET ECONOMIES, FINANCIAL STABILITY IN EMERGING ECONOMIES: A STRATEGY FOR THE FORMULATION, ADOPTION AND IMPLEMENTATION OF SOUND PRINCIPLES AND PRACTICES TO STRENGTHEN FINANCIAL SYSTEMS (April 1997), at 21.

[57] *Id.*

[58] *Id.*

[59] *Id.*

[60] *Id.*

[61] *Id.* at 3-4.

In contributing to the existence of a robust and well-functioning financial system, the international financial institutions as well as other regional development banks are playing a leading role in providing technical assistance to countries willing to build a robust financial system.[62] In doing so, sound principles and practices have been developed by different bodies in co-operation with the international financial institutions and national authorities such as the Basel Committee on Banking Supervision (Basel Committee),[63] the International Accounting Standards Board (IASB),[64] the International Organisation of Securities Commissions (IOSCO),[65] and the International Association of Insurance Supervisors (IAIS).[66] These institutions have been involved in setting "international standards" in different areas.

The Basel Committee published its Core Principles for Effective Banking Supervision (Basel Core Principles)[67] which identified twenty-five main principles that are important to any bank supervisory system. As for the regulation of the capital market, the IOSCO published the Objectives and Principles of Securities Regulation.[68] This document sets out thirty principles of securities regulations with an aim to protect investors, to ensure that markets are fair, efficient and transparent and to reduce systemic risk.[69] Also, the IOSCO is working in co-operation with the IASB to develop international accounting standards.[70] Likewise the IAIS has

[62] Joseph Norton, *International Co-operative Efforts and Implications for Law Reform*, in, BANK FAILURES AND BANK INSOLVENCY LAW IN ECONOMIES IN TRANSITION, at 296 (Rosa Lastra et al. eds., Kluwer Law International, 1999).
[63] *See generally* http://www.bis.org
[64] *See generally* http://www.iasb.org.uk.The IASB preceded the International Accounting Standards Commission (IASC) established in 1973.
[65] *See generally* http://www.iosco.org
[66] *See generally* http://www.iaisweb.org
[67] IOSCO, Objectives and Principles of Securities Regulation, September (1997), *available at* http://www.iosco.org
[68] *Id.*
[69] *Id.* at 5.
[70] NORTON, *supra* note 1, at 19.

published principles, standards and guidance papers related to the regulation and supervision of insurance markets.[71]

All these standards aim to contribute to the stability of the financial markets, to guarantee efficient functioning of the financial institutions and to encourage investments and savings through providing a sound supervisory principles and practices. The implementation of these principles constitutes one main feature of an overall international strategy for the development of financial stability in emerging markets.[72] In addition, to oversee the development, implementation and coordination of these various standards, a Financial Stability Forum (FSF) has been established.[73] The mandate of the FSF is to strengthen the surveillance and supervision of the international financial system as well as assessing the vulnerabilities affecting it. Also, the FSF is to identify and to oversee actions needed to address the problems identified.[74] The efforts of the above various international financial institutions and standard- setting bodies in creating this web of international standards and principles of financial law is said to constitute an international financial architecture.[75]

However, in implementing these international practices to develop a robust financial system in the emerging market economies, three major points should be taken into consideration. Firstly, the mere application of these international practices

[71] September 1997, *supra* note 63.
[72] Norton, *supra* note 62, at 296.
[73] *See generally* http://www.fsforum.org . *See also,* George Walker, *International Financial Crisis and the Financial Stability Forum, in* INTERNATIONAL FINANCIAL SECTOR REFORM: STANDARD SETTING AND INFRASTRUCTURE DEVELOPMENT, 173[hereinafter INTERNATIONAL FINANCIAL SECTOR REFORM] (Say Goo et al. eds., Kluwer Law International, 2002)
[74] The FSF issued a Compendium of Standards listing standards relevant to international financial stability.
[75] *See generally,* Giovanoli, *supra* note 28. *See also,* Joseph Norton, *The New International Financial Architecture and Global Banking Institutions, in* INTERNATIONAL FINANCIAL SECTOR REFORM, *supra* note 73, 11.

is not sufficient.[76] The application of these international principles should involve a "*long-term societal commitment* whereby the notion of a process based upon a *rule of law* becomes ingrained within and throughout the fabric of civil, political and economic societies in emerging economies, in a substantive manner and not merely as a facade".[77]

Secondly, each reforming country should take into consideration any *sui generis* factors related to its political, economic, financial and legal systems. So, financial law reform should be in the form "made-to-order" and not "ready made" one.[78] Thirdly, a viable legal infrastructure should exist to facilitate the functioning of the well-supervised financial system. There is no international consensus on what constitute a viable legal infrastructure for financial systems.[79] However, certain core areas of law have been identified and considered to be of great importance;[80] these are: clear and defined property rights, binding and enforceable contracts, adequate company laws, adequate lending infrastructure including secured transactions law, rules governing foreign investments, rules governing bankruptcy and predictable and fair tax laws.

In fact, the existence of such viable legal infrastructure is not only important for the existence of a well-functioning financial system but it is important for the well-functioning of the whole market-based economy system. Law is the instrument through which economic policies are implemented effectively.[81] This is why; the 'rule of law' is considered one of the main features in a market economy system.[82]

[76] NORTON, *supra* note 1, at 47.
[77] *Id.* at 13.
[78] *Id.* at 26.
[79] *Id.* at 32.
[80] *Id.* at 31-32.
[81] NORTON, *supra* note 1, at 129.
[82] MARER ET AL., *supra* note 50, at 111.

Due to the importance of the law in market economies; further discussion of the 'rule of law' and the 'role of law' will be dealt with in the next section.

2.4 THE IMPORTANCE OF THE RULE OF LAW IN A MARKET ECONOMY

The idea of subjecting the governmental power to the control of the law can be traced back to the old days of the Greek philosophers.[83] Aristotle, for example, argued that 'government by laws' was superior to 'government by men'.[84] This notion is normally referred to as the 'rule of law'. The rule of law "means, in the first place, the absolute supremacy or predominance of regular law as opposed to the influence of arbitrary power, and excludes the existence of arbitrariness, of prerogative, or even of wide discretionary authority on the part of the government".[85] Consequently, in order to avoid the arbitrariness and the undue discretion of the government, laws should be clear and known in advance. In other words, certainty, predictability and transparency of the laws are associated with the concept of the rule of law.[86]

Hence, all the actions of the government should be "bound by rules fixed and announced beforehand-rules which make it possible to foresee with fair certainty how the authority will use its coercive powers in given circumstances, and to plan one's individual affairs on the basis of this knowledge".[87] The concept of the rule of law and the principles associated with it such as predictability and transparency have

---

[83] ANTHONY BRADLEY ET. AL., CONSTITUTIONAL AND ADMINISTRATIVE LAW, at 101 (Addison Wesley Longman, 1997).
[84] *Id.*
[85] ALBERT DICEY, INTRODUCTION TO THE STUDY OF THE LAW OF THE CONSTITUTION, at 198 (Macmillen, 1941).
[86] BRADLEY ET. AL., *supra* note 83, at 110.
[87] FRIEDRICH HAYEK, THE ROAD TO SERFDOM, at 54 (Routledge, 2001). However, the principles of predictability and certainty have been approved in the English case law see, for example, *Black-Clawson International Ltd v Papierwerke AG* [1975] AC 591, 638 where Lord Diplock said: "The acceptance of the rule of law as a constitutional principle requires that a citizen, before committing himself to any course of action should be able to know what are the legal consequences that will flow from it".

been further developed and extended to encompass social and economic aspects.[88] For example, command economy is viewed as an economy that lacks the "rule of law".[89]

Unlike in a command-based economy, a market-based economy should be a "rule of law" economy.[90] The "rule of law" or 'supremacy of law' is seen as a pre-condition for establishing a market economy.[91] In other words, a market economy is a legal-system economy,[92] where law provides the 'rules of the game' both substantively and procedurally.[93] These rules need to be established and maintained to create a "level playing field" where market forces can engage in economic activities with free competition and without the interference of the state. Hence, "rule of law" requires a sound and predictable legal framework.[94] This legal framework has at least four functions: "(i) to define the universe of property rights in the system; (ii) to set a framework for exchanging those rights; (iii) to set the rules for the entry and exit of actors into and out of productive activities; and (iv) to oversee market structure and behaviour to promote competition".[95]

---

[88] BRADLEY ET. AL., *supra* note 83, at 110.
[89] *See* HAYEK, *supra* note 87, at 54-55: "Economic Planning ...cannot tie itself down in advance to general and formal rules which prevent arbitrariness". *Cf.* Leughlin, PUBLIC LAW AND POLITICAL THEORY, at 84-101.
[90] Albert Chen, *The Developing Theory of Law and Market Economy in Contemporary China, in* LEGAL DEVELOPMENTS IN CHINA: MARKET ECONOMY AND LAW, *supra* note 26, 3, 4.
[91] Shihata, *supra* note 46, at xviii.
[92] Chen, *supra* note 90, at 4.
[93] THE INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT: WORLD DEVELOPMENT REPORT 1996: FROM PLAN TO MARKET, at 87 (Oxford University Press, 1996) ("under central planning, law was first and foremost an instrument of state control. Law in market economics is fundamentally different; it defines the rules of the game and gives individuals the rights and tools to enforce them").
[94] Max Weber has emphasised that predictability is an essential element for a functioning market economy. See WEBER, MAX WEBER ON LAW IN ECONOMY AND SOCIETY, at 40 (Wirtschaft et al. trans., Simon & Schuster, New York): "the universal predominance of the market consociation requires, on the one hand, a legal system the functioning of which is calculable in accordance with rational rules".
[95] Gray, *"Evolving Legal Frameworks for Private Sector Development in Central and Eastern Europe"*, (1993), World Bank Discussion Paper, No (209), at 1.

So a state, which is adopting market-based policies, should enact or reform the existing laws in order to facilitate these functions. For example, a state's constitution should define property rights and ownership.[96] Further, the exchange of rights is accomplished by ensuring that the contract law is developed to meet market-based economic needs. Moreover, rules of the entry will need to be governed by sound company and foreign investment laws.[97] More generally, the state has to ensure that its existing rules encourage foreign investors to invest in the country. Rules that govern the exit of economic enterprises will be required: that is well-developed laws of bankruptcy and liquidation.[98] Finally, the government should introduce suitable competition and anti-monopoly laws to prevent unfair competition. Throughout all this, fair and transparent administrative and procedural rules are essential.

In order to provide the appropriate legal infrastructure, the "rule of law" framework also should meet certain formal, institutional and procedural criteria.[99] Generally speaking, a "rule of law" framework necessary for a market-based economy should be based on three main elements.[100] The first element is the presence of 'legally binding rules'.[101] These substantive rules should be promulgated to the public in advance and should be clear, stable and coherent with each other.

[96] *Id.*
[97] *Id.*
[98] *Id.*
[99] David Clark, *The Many Meanings of the Rule of Law*, *in* LAW, CAPITALISM AND POWER IN ASIA: THE RULE OF LAW AND LEGAL INSTITUTIONS, at 32 (Kanishka Jayasuriya ed., Routledge, 1999). However, Ibrahim Shihata gives a very good definition of a rule of law legal system which encompasses these criteria; see his book THE WORLD BANK IN A CHANGING WORLD: SELECTED ESSAYS, Vol. I, at 85 (Franziska Tschofen et al. eds. , Martinus Nijhoff Publishers, 1991): a rule of law legal system is "a system assumes that: a) there is a set of rules which are known in advance, b) such rules are actually in force, c) mechanisms exist to ensure the proper application of the rules and to allow for departure from them as needed according to established procedures, d) conflicts in the application of the rules can be resolved through binding decisions of an independent judicial or arbitral body and e) there are known procedures for amending the rules when they no longer serve their purpose".
[100] Shihata, *supra* note 46, at xviii. *See also* Ibrahim Shihata, *The Role of Law in Business Development*, 20 FORDHAM INT'L L. J. 1577, (1997).
[101] Shihata, *supra* note 38, at xix.

Modification of these rules should be guided by law according to previously disclosed and fair procedures.[102] These rules should include several laws governing commercial and financial activities.[103]

The second element is the existence of 'appropriate processes'.[104] These processes include: fair and transparent rule-making, rule-enforcing and rule-changing.[105] There should be clear procedures which are known in advance of how rules and laws are being enacted, enforced and changed. The third element is the existence of 'well-functioning public institutions'.[106] Public administrative institutions should apply the laws in a fair manner without arbitrariness or corruption. Equally or even more importantly, an independent and effective judiciary which applies the laws and the rules is important for a market-based economy.[107]

In sum, the "rule of law" in a market-based economy and as to the attendant financial system necessitates a strong legal infrastructure. This legal framework, as discussed, is the *means* through which the developing country achieves and applies its economic polices successfully and in an effective manner. States which are adopting market-based policies should not underestimate the importance of the law.

3. THE CONCEPT OF LEGAL PLURALISM

Developing countries that are in the process of modernising their legal systems to accommodate market-oriented reforms face the challenge in adapting their domestic legal systems and principles with these market-oriented policies. A potential result of the interaction between the domestic laws and the new market-oriented policies/laws

[102] Clark, *supra* note 99, at 32 (referring to these as the formal criteria).
[103] Shihata, *supra* note 46, at xix.
[104] *Id*
[105] *Id*
[106] *Id.* at xx.
[107] *Id.* at xxi.

is "legal pluralism". This might adversely affect the "rule of law" and in turn the proper establishment of a market-oriented legal infrastructure. The following discusses this theme in detail.

3.1 OVERVIEW

The concept of "legal pluralism" under general jurisprudential theories is originated as an alternative to the idea of "legal centralism". The view of legal centralism is that "law is and should be the law of the state, uniform for all persons, exclusive of all other law, and administered by a set of single of state institutions".[108] Opponents of legal centralism argue that the idea is a 'myth'.[109] This debate encompasses legal, political and social dimensions. A core contention respecting legal pluralism can be analysed by addressing two main issues. Firstly, what is the definition of the concept itself: what is legal pluralism? Secondly, does legal pluralism exist at all? These jurisprudential issues involve other related fields including sociology and anthropology. The concept of legal pluralism is still a developing notion without definitive parameters.

This Section aims to provide an overview of the various definitional components of the concept of legal pluralism and review the possible practical approaches to deal with in this concept. In doing so, this section will try to answer the question whether the existence of legal pluralism, such as in Saudi Arabia, as will be seen in Chapter Two, affects the concepts of "rule of law" of a market-based economy system and rule-based/rule of law oriented legal infrastructure. This Section, however, *does not* attempt to join the fray with legal pluralist theorists who are debating the *general* definition of legal pluralism and does not seek to provide 'a descriptive conception of legal pluralism'.

[108] John Griffiths, *What is Legal Pluralism?*, 24 Journal of Legal Pluralism 1, 3, (1986).
[109] *Id*, at 4: "Legal pluralism is the fact. Legal centralism is a myth, an ideal, a claim, an illusion".

3.2 THE DEFINITIONAL PARAMETERS OF LEGAL PLURALISM

Legal pluralists have not agreed on one single definition for the concept of legal pluralism. Generally speaking, legal pluralism can be defined as "the condition in which a population observes more than one body of law".[110] A more specific and helpful approach to the study of legal pluralism finds a significant pedigree in the separate works of Vanderlinden and Hooker.[111] Their work provides a significant contribution in understanding the concept. Vanderlinden defines legal pluralism as: "the existence within a particular society of different legal mechanisms applying to identical situations".[112] According to Vanderlinden's definition of legal pluralism the 'different legal mechanisms' should apply to *identical situations*. Accordingly, for Vanderlinden, when different legal mechanisms apply to *different* situations, it is a *plurality* of law rather than legal pluralism.[113] In his work, he provides various examples that he considers to reflect legal pluralism.[114] Vanderlinden gives, *inter alia,* the following examples:[115]

- The merchant who sells goods is subject to a different contractual mechanism from the ordinary citizen who conducts the same operation.[116]
- The diplomat, under protection of his 'immunity', benefits from legal mechanisms other than those which apply to the inhabitants of the country in which he performs his duties when the latter are in identical situation.[117]

---

[110] Gordon Woodman, *The Idea of Legal Pluralism*, in LEGAL PLURALISM IN THE ARAB WORLD, 3 [hereinafter *Legal Pluralism*] (Baudouin Dupret et al. eds., Kluwer Law International, 1999).
[111] *See also* John Gilissen who edited essays published under the title *Le pluralisme juridique* in 1971. *See also* Gordon Woodman, *Ideological Combat and Social Observation: Recent Debate about Legal Pluralism*, 42 J. OF LEGAL PLURALISM & UNOFFICIAL L. 21, at 23-24, (1998) (referring to John Gilissen). According to Woodman, Gilissen implied a definition of legal pluralism in his introduction. Woodman, also, refers to *Jacus Vanderlinden,* who contributed to the volume edited by Gilissen. *See also* BARRY HOOKER, LEGAL PLURALISM: AN INTRODUCTION TO COLONIAL AND NEO-COLONIAL LAWS (Clarendon Press, 1975).
[112] Woodman , *supra* note 110, at 4.
[113] Woodman, *supra* note 111, at 25.
[114] *Id.*
[115] These examples have been translated by Woodman, *supra* note 102, at 4.
[116] *Id*

- Different mechanisms which apply to adults and minors.[118]
- The laws of an insurgent group which is in a conflict with the state and its laws.[119]

However, Hooker in his comparative study defines legal pluralism as "the situation in which two or more laws *interact*".[120] In his study Hooker was concerned to describe "the systems of legal pluralism in the contemporary world which have resulted from the transfer of whole legal systems across cultural boundaries".[121] Hooker argues that there are number of reasons where a state's legal system might be ineffective.[122] This arises where there are "multiple systems of legal obligation existing within the confines of the state".[123] Hooker enumerates four situations where the 'multiplicity of obligation' occurs. The first instance where 'multiplicity of obligation' arises is through colonial laws.[124] The imperial power determines the legal structure in the colonial territories. Even after the independence of these colonies, the colonial laws still constitute the legal system along with the 'indigenous law'.[125] Secondly, 'multiplicity of obligation' arises in states where indigenous people are administered as a disadvantaged class.[126] Thirdly, 'multiplicity of obligation' arises where some states voluntarily adopt Western laws in order to modernise their legal systems.[127] Finally, the multiple obligations arise when a penal

---

117 *Id.*
118 *Id*
119 *Id.*
120 HOOKER, *supra* note 111, at 6.
121 *Id.* at 1.
122 *Id.* at 2.
123 *Id.*
124 *Id.*
125 *Id.*
126 *Id.*
127 *Id.* at 3.

statute is passed to abolish traditional systems and introduce 'revolutionary ideology'.[128]

However, Vanderlinden's and Hooker's views have been attacked and critically debated. The main debate revolves around the definition of legal pluralism. These debates have extended the definition of "legal pluralism" and divided such concept into two main categories.[129] The first category is the so-called 'state legal pluralism' which refers to the existence of "two bodies of norms within the law of the state".[130] The second category is what is referred to as 'deep legal pluralism'.[131] It means the existence of the law of state along with other 'normative orders' that are not directly associated with the state.[132] It has been referred to as *deep* because the distinction between its laws goes deeper in separating state law from non-state law as compared to state legal pluralism that is just a distinction within the body of state laws.[133] The second category is the result of sociological contributions rather than legal ones.[134]

Despite the above-mentioned debates and the fact that legal pluralism has been divided mainly into two types: that is *deep legal pluralism* or *state legal pluralism*, it is evident that forms of state legal pluralism are recognised to be existing.[135] However, whether state legal pluralism should be the *means* to define 'a descriptive conception of legal pluralism' or should be excluded is not the purpose of this study. As will be seen in Chapter Two, state legal pluralism exists in Saudi Arabia and its existence affects the functionality of the financial and banking systems. Should such

[128] *Id.* However, the focus in this volume is on the third situation due its relevance for the purposes of this thesis.
[129] Woodman, *supra* note 110, at 5.
[130] *Id.*
[131] *Id.*
[132] *Id.*
[133] Gordon Woodman, *'Legal Pluralism and the Search for Justice'*, 40(2) J. OF AFRICAN L. 152, 159, (1996).
[134] Woodman, *supra* note 110, at 5.
[135] *See* Hooker , *supra* note 111.

legal pluralism be maintained, abolished, or modified is an issue that the author will be explaining in this volume.

3.3 LEGAL TRANSPLANTATION AND STATE LEGAL PLURALISM

Legal transplantation is "the moving of a rule or a system of law from one country to another".[136] This movement happens during the process of law-making or legal reform.[137] As law is used as an instrument to apply efficiently the policies necessary for economic development,[138] developing countries would be induced to borrow and to adopt voluntarily other successful legal models or "ready-made laws" and to transplant them into their own legal systems with the aim to develop their own existing legal infrastructures to which in turn will accommodate their new economic policies.

The idea of transplanting legal models is motivated by two reasons. Firstly, certain legal models have proven to be successful in the economic and legal environments of their donor state.[139] Secondly, the aim to accelerate the legal reform process in developing countries or the transplantee states because these states are not in the position to wait for the development of their own legal models.[140] The theory of legal transplantation finds its roots in the work of Watson, arguing against the "mirror theories of law".[141] The mirror theory of law describes law as the mirror of the society and that the law is not an autonomous set of rules and concepts.[142] On the

[136] ALAN WATSON, LEGAL TRANSPLANTS: AN APPROACH TO COMPARATIVE LAW, at 21 (1974)
[137] Lukas Mistelis, *Regulatory Aspects: Globalisation, Harmonisation, Legal Transplants, and Law Reform – Some Fundamental Observations*, 1055 INT'L LAW ..., 1067, (2000) referring to Eric Stein, *Uses, Misuses and Non-uses of Comparative Law*, 72 NW.U.L.Rev 198, 202, (1977).
[138] NORTON, *supra* note 1, 129.
[139] *Id.* at 130.
[140] *Id.*
[141] William Ewald, *Comparative Jurisprudence (II): The Logic of Legal Transplants'*, 43AM. J. COMP. L, 489, 492, (1995).
[142] *Id. See also*, LAWRENCE. FRIEDMAN, A HISTORY OF AMERICAN LAW, at 12 (Simon & Schuster, 1985) (mentions that the law is "not as a kingdom unto itself, not as a set of rules and concepts, not as

contrary, Watson believes that there is no necessary inherent relationship between the society and the law that is operating within it.[143] He argues that law develops by transplanting often with no connection with the society's structure.[144] According to him, "most changes in most systems are the result of borrowing"[145] by different *means.*[146]

Kahn-Freund[147] disagrees with Watson's argument that there is no inherent relationship between society and the law, which is operating within it. He argues that any attempt "to use a pattern of law outside the environment of its origin continues to entail the risk of rejection".[148] Also, he argues that there are "degrees of transferability".[149] According to him, in order to study the viability of exporting a rule to transplant it in the transplantee state, the social and political environments in both the transplantor and transplantee states and their relationship to the rule must be studied and compared.[150] Regardless of any argument for or against legal transplants and their relation to the society, legal transplants are facts of modern economic development though and their effectiveness in the transplantee country should be evaluated and monitored on a case-by-case basis. It is evident; however, that no

the province of lawyers alone, but as mirror of society. It takes nothing as historical accident, nothing as autonomous, and everything as relative and moulded by economy and society").

[143] Alan Watson, *Comparative Law and Legal Change*, 37 CAMBRIDGE L. J. 313, 313-314, (1978): "There is no exact, fixed, close, complete, or necessary correlation between social, economic or political circumstances and a system of rules of private law".

[144] Watson, *supra* note 136, at 315.

[145] *Id.* at 94.

[146] *Id.* at 30 stating that: "Actually, receptions and transplants come in all shaped and sizes. One might think also of an imposed reception, solicited imposition, penetration, infiltration, crypto-reception, inoculation and so on, and it would be perfectly possible to distinguish these and classify them systemically.... No point in elaborating a detailed classification of borrowing until individual instances has been examined to see what they reveal".

[147] Kahn-Freund, *'On Uses and Misuses of Comparative Law'*, 37(1) MOD. L. REV. 1, (1974).

[148] *Id.* at 27.

[149] *Id*, at 6. He states: "In most cases we must ask what chances there are that the new law will be adjusted to the home environment and what are the risks that it will be rejected. The chance and inversely, the risk, may be smaller or larger, and the magnitude of this chance and of this risk determine the point on the scale at which we have to place the foreign law".

[150] *Id*, 11-13. *See also* Mistelis, *supra* note 137, at 1066.

country can develop by simply transplanting legal models from developed countries.[151] It is a long-term process which involves education, adaptation, assimilation of the transplanted law and "reconciliation" between external and internal influences.[152] A plausible argument is that, failure to educate, to adapt, to assimilate and to reconcile the transplanted law within the legal system of the transplantee state leads to a legal plurality in the legal system (*i.e.*, a *state* legal pluralism). In fact, failure to reconcile the transplanted laws is one of the reasons, as argued by Hooker, that leads to a state legal pluralism.[153] Hooker describes this process by stating that:

> "multiple obligation arises in those states which have voluntarily adopted western laws with the motive of modernising themselves.... A *legal plurality* arises here quite simply because the original is by no means displaced in whole or in part by the introduced law. There are number of reasons for this and they commonly include the non-communication or maladministration of the new law... The result is a conflict of principle which is settled in a number of different ways or, more often than not, left unsolved".[154]

[151] Norton, *supra* note7, at 130. *See also* PATTI OFOSU-AMAAH, REFORMING BUSINESS-RELATED LAWS TO PROMOTE PRIVATE SECTOR DEVELOPMENT: THE WORLD BANK EXPERIENCE IN AFRICA, at 18-19 (The International Bank for Reconstruction and Development, 2000). *See also* ANN SEIDMAN ET AL., STATE AND LAW IN THE DEVELOPMENT PROCESS: PROBLEM-SOLVING AND INSTITUTIONAL CHANGE IN THE THIRD WORLD, at 44 (St. Martins Press, 1994) states: "Turkey copied French law; Ethiopia copied Swiss law, the French-speaking African colonies, French law, Indonesia, Dutch law. Universally, these laws failed to induce behaviour in their new habitats anything like [that] in their birth places. Inevitably, people chose how to behave, not only in response to law, but also to social, economic, political, physical, and subjective factors arising in their own countries from custom, geography, history, technology, and other, non-legal circumstances".

[152] *See* Norton, *Id*, arguing that developing countries should not undermine the usefulness of the comparative law methodology. He further argues that the relevance of this methodology is both external and internal. By external he means that developing countries should not undermine external available models. This has to be reconciled with the "internal influences" that is internal legal, economic and political environment.

[153] *See supra* Section 3.2.

[154] Hooker, *supra* note 111, at 3.

Hooker raises an important point which results from the maladministration or non-communication of the new rule; that is, the conflict between the existing law and the borrowed law. In other words, he impliedly argues that state legal pluralism might include conflicting legal rules, if it is left *unsolved.* Conflicting laws within the same legal system of the state, as a corollary, leads to inefficiency. Having reached such a logical conclusion, there are two suggestions to avoid this 'inefficiency'. First, the transplantee state should exercise its best efforts to succeed in the 'communication' and 'administration' of the new law, thus avoiding the existence of conflicting legal rules and in turn *legal plurality* or state legal pluralism.

Alternatively and secondly, the transplantee state can borrow the legal 'organ' (*i.e.*, model of a certain law) and create for it a complete new body of law to eliminate any risk of conflict between this new 'organ' and the existing law. Thus, such model has been introduced in the DIFC where certain laws were enacted to facilitate international financial activities; but these laws were *segregated* from the state's own legal system. In other words, the DIFC has been established as a "free zone" with its own laws and systems.[155] Another example could be Malaysia, where an Islamic financial system, with its own governing laws and regulations, has been established alongside the conventional financial system (*i.e.*, a system *alongside* a system).

To elaborate further, Hooker argues that *legal plurality* arises because the new introduced law 'by no means displaced in whole or in part' the original law. The author's suggestion is that this is one of the possibilities. Another possibility is that *legal plurality* could arise if the new introduced law is constructed to work alongside

[155] *See generally* Michael Blair et. al., *Legal Issues Arising in the New Dubai International Financial Centre*, 20 J.I.B.L.R 207, at 207, 2005.

the existing system or as a separate "free zone" coexisting with exiting system. In this sense, there is no "*displace* in whole or in part", to the original existing law.

There are various reasons for such models. For example, the population of a developing country might consist of different communities with cultural or religious different orientations. Another example could be that the new introduced law will act as a 'supporting machine' to the existing original law until the original law is further evolved and "re-activated" in an effective manner: thus, the new introduced law could be used *temporarily*. Finally, as it is the case in the DIFC, the main reason for such model is to attract international investment and capital.

Hence, it is possible to argue that there are two types of *state* legal pluralism. Firstly, the 'conflicting' state legal pluralism that consists of conflicting rules and laws resulting from introducing new laws. This conflict between the rules within the same legal system would leave the developing country with its *status quo* but with no further development or improvement: *destruction rather than construction.* Secondly, is the 'non-conflicting' state legal pluralism. In this situation, we have legal plurality or different legal rules within the same legal system working alongside each other and with no conflict between them.

It can be concluded that if the 'conflicting' state legal pluralism exists; the state has to take one of the following measures: 1) to unify the conflicting rules into one legal system (that is adapting the transplanted rules to the existing ones or the existing ones to the transplanted rules); or 2) in case the state it is unsuccessful to achieve the previous measures, to further 'pluralise' the 'conflicting' state legal pluralism to reach the level of 'non-conflicting' state legal pluralism. The result is that instead of observing a "system *within* a system", there develops a "system *alongside* a system".

While there is a level of obscurity surrounding a general discussion of these matters, it is hoped further clarifications will come about with subsequent country and model specific discussions (*e.g.*, in Chapter Two as to Saudi Arabia and Chapter Five as to Malaysia and DIFC). In any event, it will be pertinent to argue that the concept of 'conflicting' state legal pluralism is inconsistent with the basic elements of the 'rule of law'. As the 'rule of law' is an important component in a market-based economy, it will be important for this thesis to demonstrate that 'non-conflicting' legal pluralism can be structured in a way consistent with the rule of law.

3.4 A CRITICAL LINKAGE? LEGAL PLURALISM AND RULE OF LAW

This Chapter attempts to create a "chain". First of all we have market economy which is considered an important model for development. Secondly, market economy is a "rule of law" economy. Hence, the establishment of a rule of law and in turn a viable legal framework is important. Then we have a certain form of legal pluralism, which might cause conflict of rules within the legal system of the state. At this juncture, the question is whether the existence of "legal pluralism" adversely affects the necessary components of the "rule of law". In case this question is answered in the affirmative, the existence of "legal pluralism" could be considered to impair the establishment of a successful market-economy. In other words the chain has been broken.

The argument that "legal pluralism" is not compatible with the "rule of law" finds a strong basis when *deep* legal pluralism is concerned.[156] The main reason, arguably, is that in some cases a person is subject to conflicting duties.[157] This is because the

[156] Woodman, *supra* note 133, at 160.
[157] *Id.* This is one of the two reasons which Woodman presented in his article where deep legal pluralism is considered to be against the rule of law. The second reason is where persons and officials follow the norms and values customary law (for example to be engaged in nepotism) and disregard the

existence of both state law and indigenous or customary law. According to Woodman "the competing sources of legitimacy give rise to competing duties, and consequently the *rule of law* cannot totally prevail".[158] However, the argument that *deep* legal pluralism would be against the "rule of law" can be extended to encompass state legal pluralism.[159] Whether state legal pluralism could be against the rule of law depends on what one means by state legal pluralism.[160] As discussed previously, state legal pluralism could result from legal transplantation and it can be divided into two categories: namely 'conflicting' state legal pluralism and 'non-conflicting' state legal pluralism.

As the "rule of law" requires predictability and certainty in the legal framework,[161] it can be argued that the 'conflicting' state legal pluralism is against the "rule of law". Inconsistent rules within the same legal system will affect the certainty, predictability and enforcement of the legal transactions and procedures. 'Non-conflicting' state legal pluralism, on the other hand, should not adversely affect these requirements of the "rule of law". This is because under such form of "legal pluralism", there are no rules that conflict with each other. Instead, the legal rules are functioning alongside each other. That is, each component has its own predictable and certain rules and procedures.

Therefore, the conclusion being taken for the purposes of this thesis is that while it is plausible to argue that legal pluralism is against the "rule of law", this would be

values and norms of the state law. He disagrees that such situation infringes the rule of law to a great extent because it contributes the rule of customary law. *See id*

[158] *Id.*

[159] Woodman, *supra* note 110, at 12, (stating in the footnotes that: "The ideals of the *rule of law* and equality before the law as propounded in the context of legal positivism do indeed seem to be opposed to state legal pluralism". It is further argued the state legal pluralism is against the principle of equality before the law. It is pertinent to note that such argument against state legal pluralism is when state legal pluralism means 'different norms to be applied to different persons in the same situations"), *see also* Woodman, *supra* note 133, at 160.

[160] *See* discussions of the definition *supra*.

[161] *See supra* note 87; *see also* the discussion of the rule of law *supra*.

true in the case of 'conflicting' state legal pluralism. 'Non-conflicting' state legal pluralism, on the other hand, is not necessarily against the "rule of law". Hence, if the "rule of law" is undermined by the existence of 'conflicting' state legal pluralism, the state should further 'pluralise' the legal system to maintain the "rule of law". But in further 'pluralising' (*i.e.*, adopting the 'non-conflicting' approach), a state will still need to ensure that this form of pluralism (*i.e.*, 'non-conflicting' state legal pluralism) incorporates *all* of the required components of the "rule of law". That is, predictability, certainty and a rule-based legal infrastructure.

4. ISLAMIC COUNTRIES IN GLOBAL ECONOMY AND THE RESULTING PLURALISM

By the end of the colonial era, the newly independent Islamic states have witnessed the advent of their national economic and legal policies. Such has received a particular attention from the newly formed governments because it further reaffirmed their independence as sovereign states. Nevertheless, during this period, "legal transplants" provided a significant source for the Islamic countries in building up their independent legal systems. For example, Egypt was inspired by the French Napoleonic code which has later influenced other neighbouring Islamic countries.[162]

However, for the reasons explained below; Islamic *Shari'a* has a juridical importance and remains influential in the Islamic countries.[163] For example, in most Islamic countries the issue whether Islamic *Shari'a* should be the paramount legal system of these countries has always been on the agenda.[164] Also, with varying degrees, Islamic *Shari'a* has always provoked legal debates in the Islamic countries.

[162] *See generally* Nabil Saleh, *How Will the Shari'a Influence Middle East Contract Law over the Next 20 Years?*, 24 MIDDLE E. EXECUTIVE REP. 9, at 11, (2001).
[163] Lu'ayy Al-Rimawi, *Relevance of Shari'a in Arab Securities Regulation with Particular Emphasis on Jordan as an Arab Regulatory Model*, 27 COMP. LAW. 227, at 227 (2006).
[164] Most recently in the case of Iraq.

Most importantly, for the purposes of this thesis, are the legal debates generated through the interaction between modern finance and the Islamic *Shari'a*.

Foreign banks have played an important role in financing trade and development in the Islamic countries.[165] Because modern finance practices are inconsistent with the Islamic *Shari'a*, for reasons which will be explained below, initiatives as early as 1960 have aimed at developing an alternative finance model which culminated with the development of "Islamic finance". The concept of "Islamic finance" has received a warm welcome from few Islamic countries that embarked at Islamising their financial systems. Others have allowed "Islamic finance" to function alongside conventional modern finance.[166] Along the spectrum, these countries have varied in their view of "Islamic finance". Some countries have supported "Islamic finance", and others have adopted the gradual policy of "wait and see". This section aims to introduce Islamic *Shari'a,* to differentiate between conventional modern finance and "Islamic finance" and to highlight the pressures that Islamic countries are facing in the global economy and its associated legal policies.

4.1 THE LAW OF ISLAMIC *SHARI'A*

Shari'a, sometimes referred to as *Shariah,* is an Arabic word which means the path to be followed and literally means the way to a watering place.[167] The jurisprudential meaning of *Shari'a*, however, is the regulations and rules made by God for his mankind to follow.[168] There are primary and secondary sources of the

[165] IBRAHIM WARDE, ISLAMIC FINANCE IN THE GLOBAL ECONOMY, at 49 (Edinburgh University Press, 2000).
[166] *See* definition of "conventional finance" *infra*.
[167] *See* ABDUR RAHMAN DOI, *SHARIAH:* THE ISLAMIC LAW, (Ta Ha Publishers, 1987).
[168] *See* ABDUL AL-SALAM ET AL., AN INTRODUCTION TO LEGISLATION PRINCIPLES IN SAUDI ARABIA, at 9 (Dar El-Ketab El Jameae, 1983) [in Arabic].

Islamic *Shari'a*. The primary sources are the Holy *Quran* and the *Sunna*.[169] The Holy *Quran* contains broad and general legal propositions.[170] The second primary source of the Islamic *Shari'a*, the *Sunna*, is an important complementary source for the *Quran*. The *Sunna* is all the teachings, statements or deeds by the Prophet Muhammad. It is also what the Prophet has approved to be legitimate under Islamic *Shari'a* either expressly or implicitly. Hence, the *Sunna* is a supplement to the *Quran* and plays an important role for both religious and legal purposes.[171]

However, there are secondary sources for the Islamic *Shari'a* which must be taken into consideration due to their modernity importance. These secondary sources are important because, for example, the above-mentioned primary sources do not encompass complex laws related to banking, finance and insurance. Therefore, Islamic scholars will use the secondary sources in order to devise laws and rules that satisfy both the modern need for such laws and its Islamic compliance. The main secondary source is *ijtihad*, which means the independent reasoning[172] or "an exercise to arrive at one's own judgement".[173] *Ijtihad* is a process that involves reviewing the texts of the *Quran* and the *Sunna* and it has five main sources:[174]

1. *Ijma* or (consensus of opinions):[175] *Ijma* is defined as "the consensus of opinion of the companions of the Prophet and the agreement reached on the decisions taken... by the Jurists on various Islamic matters".[176]

[169] ABDUR RAHMAN DOI, *SHARIAH:* THE ISLAMIC LAW, at 21 & 45 (Ta Ha Publishers, 1987).
[170] Some areas of the *Shari'a* have been mentioned in more details such as the law of inheritance. Others have been mentioned in more general terms; such as sale contracts where four versions been mentioned only in the Quran leaving mankind to deal with the details. *See* ABDUL AL-SALAM ET AL., *supra* note 168, at 74.
[171] DOI, *supra* note 167, at 49.
[172] M. QAL AJI ET AL., DICTIONARY OF ISLAMIC LEGAL TERMINOLOGY (Arabic- English- French), at 21 (Dar An-Nafase, 1996).
[173] DOI, *supra* note, at 78.
[174] ABDUL AL-SALAM ET AL., *supra* note 168, at 80 (however, these sources are outside the scope of this thesis).
[175] DOI, *supra* note 167, at 64.

2. *Qiyas* or (analogical reasoning): *Qiyas* is a method by which "the principles established by Quran, *Sunna* and *Ijma* are to be extended and applied to the solution of new problems not expressly regulated before".[177] The justification of the extension is on the ground that the new situation might share a common characteristic with the old situation.[178]

3. *Masalih Al-Mursalah* or (Public Interest):[179] Public interest is regarded in the Islamic *Shari'a* as a basis for the law.[180]

4. *Istishab* or (Presumption of Continuity):[181] *Istishab* means "a rule of evidence or a legal presumption of continuance of conditions".[182] An example of that is the presumption of permissiveness, which means that specific situations or legal transactions should be allowed as long as there is no express evidence for otherwise.

5. *Sadd al Dharai* or (Prohibition of Evasive Legal Devices):[183] Broadly, this secondary source means that any thing or situation which leads to something or situation against which is illegitimate under Islamic *Shari'a* is to be considered illegitimate as well. In that it is blocking the way to the illegal.

Opinions and interpretations regarding different issues and novel situations have been introduced by Islamic scholars using the above-mentioned sources. Hence, Islamic *Shari'a* is described as "a compilation of opinions and interpretations of religious legal scholars who studied the sacred texts of Islam during the first

---

[176] *Id.*
[177] *Id.* at 78.
[178] FRANK. VOGEL ET AL., ISLAMIC LAW AND FINANCE: RELIGION, RISK, AND RETURN, at 51 (Kluwer Law International, 1998).
[179] DOI, *supra* note 175, at 81.
[180] *Id.*
[181] QAL AJI ET AL., *supra* note 172, at 41.
[182] DOI, *supra* note 175, at 83.
[183] QAL AJI ET AL., *supra* note 172, at 191.

centuries of its existence".[184] It is more accurate, however, to use this description in referring to the Islamic *fiqh* because Islamic *Shari'a* is much broader. In simple terms, Islamic *fiqh* is the classical Islamic law represented by the four *main* Schools.[185] These are the *Hanafi* School, the *Malaki* School, the *Shafi* School and the *Hanbali* School.[186] Different views and interpretations resulted from the different reading of the main sources of the *Shari'a*.

The Ottomans at a later stage have contributed towards the codification of the Islamic *Shari'a*. They introduced *Majalat Al-Ahkam Al-Adliyah,*[187] sometimes referred to as the *Mejelle* and hereinafter referred to as *Majalla*. The *Majalla* is a summary of certain Islamic jurisprudence principles based on the *Hanafi* School. The *Majalla* constitutes an essential source of legislation to many Arab countries. Later in Saudi Arabia, a similar code has been introduced namely; *Majalat Al-Ahkam Al-Shri'yah,*[188] which is similar to the *Majalla* but is based on the *Hanbali* School.

The importance role of the Islamic *Shari'a* is still present despite the fact that many of the Arab and Islamic countries have introduced "positive" laws that, arguably, are not driven from the Islamic *Shari'a*. According to Al-Rimawi, the importance of the Islamic *Shari'a* is attributed to three reasons.[189] Firstly, the constitutional role of the Islamic *Shari'a*. Thus, the majority of the Arab constitutions refer to the Islamic *Shari'a* as a principal source of the law.

---

[184] Enid Hill, *Comparative and Historical Study of Modern Middle Eastern Law*, 26 Am. J. Comp. L. 279, at 292 (1977-1978).
[185] There are other Islamic Schools. However, references to the Islamic *Shari'a* throughout this volume is including Islamic *fiqh*,
[186] These are the main *Sunni* Islamic *Shari'a* Schools. Each school name itself after its founding scholar. *See* VOGEL, *supra* note 178, at 9.
[187] For a translation of *Majalat Al-Ahkam Al-Adliyah see* THE CIVIL LAW OF PALESTINE AND TRANS-JORDAN (Volume 1) [hereinafter THE CIVIL LAW OF PALESTINE] (C. A. Hooper trans., Azriel Printing Works, 1933). *See also* THE MEJELLE BEING AN ENGLISH TRANSLATION OF MAJALLAHEL-AHKAM-I-ADLIYA AND A COMPLETE CODE ON ISLAMIC CIVIL LAW, [hereinafter THE MEJELLE] (Tyser et al. trans., Law Publishing Company, 1901; reprint 1967).
[188] *See* AHMAD AL-QARI, *MAJALAT AL-AHKAM AL-SHRI'YAH*, (Tihama Publications, 1981).
[189] Al-Rimawi, *supra* note 163, at 227.

Secondly, Islamic *Shari'a* in the different Arab countries and at varying degrees plays a "gap-filling" role. To elaborate, other than those Arab countries that apply Islamic *Shari'a* as the paramount legal system such as Saudi Arabia, other countries have introduced civil and commercial codes that are modelled on Western laws. These civil codes have referred to the Islamic *Shari'a* as a "gap-filling" source of law.

Finally, the importance of the *Shari'a* is not only attributed to the fact that it is mentioned in the various legal legislations of the Arab countries. As Al-Rimawi suggests correctly, Islamic *Shari'a* has an "ever-enduring societal relevance".[190] In this sense, the influence of the Islamic *Shari'a* on the Muslim communities should not be undermined. As will be seen below, the *Shari'a's* prohibition of certain elements of modern finance has precluded many Muslims from investing using modern finance methods although such is legally allowed.[191] In other words, Islamic *Shari'a* does affect the "credit culture" of the Muslim communities and this "credit culture" can not be legislated.

4.2 ISLAMIC *SHARI'A* AND MODERN FINANCE

Certain principles of the Western-style financial systems are in direct contradiction with the principles of Islamic *Shari'a*. Firstly, unlike modern finance; Islamic *Shari'a* does not recognise the trade of money as a subject-matter of trade.[192] Usmani explains: "[under Islam] money has no intrinsic utility; it is only a medium of exchange; each unit of money is 100 per cent equal to another unit of the same denomination; therefore, there is no room for making profit through the exchange of these units *inter se*. Profit is generated when something having intrinsic utility is sold

[190] *Id.*
[191] *Id*. at 229.
[192] MUHAMMAD USMANI, AN INTRODUCTION TO ISLAMIC FINANCE, at xiv (Kluwer Law International, 2002).

for money or when different currencies are exchanged, one for another".[193] In other words, Islam approves financing when it is an asset-backed financing.[194]

The second issue is the Islamic prohibition of interest as a form of *riba*. The third issue is the Islamic prohibition of *gharar* (risk, uncertainty and speculation).[195] These principles of Islamic *Shari'a* may frustrate many conventional finance transactions. As a result, in theory at least, investors should not have high expectations when transacting businesses that are subject to Islamic *Shari'a*, because Islamic *Shari'a* has different understanding of investments as will be explained further below. The following, however, aims to give a general overview of the main two Islamic *Shari'a* elements that might frustrate conventional financial transactions.

4.2.1 THE PROHIBITION OF INTEREST

The issue of interest in financial transactions is one of the most controversial issues in the Muslim world and has been subject to a long-standing debate.[196] Charging interest in financial transactions has been considered to be *riba* under Islamic *Shari'a*; and in turn, illegal.[197] *Riba* is an Arabic word meaning, literally, "increase"[198] and generally, signifies "any unjustified increase of capital for which no compensation is given".[199] The word *riba* should not be equated with the charging

[193] *Id.* at xiv - xv.
[194] *Id.* at xiv.
[195] *See* the discussion *infra*.
[196] *See generally* Ghilbli Mallat, *The Debate on Riba and Interest in Twentieth Century Jurisprudence, in* ISLAMIC LAW AND FINANCE, 69 (Ghilbli Mallat ed., Graham & Trotman, 1988). *See also* NABIL SALEH, UNLAWFUL GAIN AND LEGITIMATE PROFIT IN ISLAMIC LAW (Graham & Trotman, 1992).
[197] There some other opinions which consider charging interest are not *riba*.
[198] Ibrahim Shihata, *Some Observations on the Question of Riba and the Challenges Facing 'Islamic Banking, in* YEARBOOK OF INTERNATIONAL FINANCIAL AND ECONOMIC LAW (2000-2001), at 25 (Joseph Norton et al. eds., BIICL, 2003). *See also* WILLIAM. BALLANTYNE, COMMERCIAL LAW IN THE ARAB MIDDLE EAST: THE GULF STATES, at 122 (Graham&Trotman, 1992).
[199] WILLIAM BALLANTYNE, ESSAYS AND ADDRESSES ON ARAB LAWS, at 122 (Curzon Press, 2000).

of interest on loans in financing transactions as such phenomenon did not exist at the time of the primary sources of the Islamic *Shari'a* (*i.e., Quran* and *Sunna*).[200]

Riba has been mentioned and condemned in the primary sources of the Islamic *Shari'a.* While the *Quran* refers expressly to one form of *riba*; it does not further define *riba* or its forms.[201] The type of *riba* which has been referred to in the *Quran* expressly is a pre-Islamic practice; the so called "pay or increase".[202] In this form of *riba*, creditors used to double the principal upon default by the debtors in return for an extension of the repayment period.[203] This form of *riba* includes charging the debtor any amount as a penalty for failure to pay on time.[204]

The *Sunna* reaffirms the prohibition of *riba* and extends the concept of *riba* further to encompass other forms, namely; *riba* in sales and *riba* in loans. More relevant to this study is the *riba* in loans because it concerns the loan contract.[205] The *Sunna* prohibition of *riba* in loans derives, *inter alia,* from the Prophet's saying "every loan that attracts a benefit is *riba*".[206] Therefore, interest charged on loans is considered to be a benefit and is banned under Islamic *Shari'a.* Such conclusion has universal acceptance among Islamic scholars.[207]

4.2.2 THE PROHIBITION OF GHARAR

The second issue that affects financial transactions is the Islamic prohibition of *gharar. Gharar* has no precise meaning and Islamic jurists have differed on its

[200] Shihata, *supra* note 198, at 26.
[201] *Id.* at 25.
[202] VOGEL ET AL., *supra* note 178, at 73 (Kluwer Law International, 1998).
[203] *Id.* Also, this is referred to as "*riba al-jahiliyya*".
[204] *Id.*
[205] On *riba* in sales *see* VOGEL ET AL., *supra* note 178, at 74-77.
[206] *Id.*
[207] VOGEL ET AL., *supra* note 178, at 77. For more detailed study on *riba* and the different opinions of the different Islamic Schools *see* SALEH, *supra* note 196.

definition.[208] Literally, *gharar* means fraud[209] but in transactions the word *gharar* is normally used to mean risk, uncertainty, hazard[210] and speculation.[211] Hence, because of *gharar*, Islamic *Shari'a* prohibits any transaction which involve unjustified enrichment through pure chance[212] and any transaction which involves elements of speculation.[213] Also, because of *gharar*, Islamic *Shari'a* considers a contract of sale invalid where there is uncertainty regarding the object of the sale or its price. Thus, *gharar* "includes both ignorance of the material attributes of the subject-matter of a sale, and also uncertainty regarding its availability and existence".[214] A classical example is the sale of a fish in the sea.[215]

However, the different definitions of *gharar* that are given by the different Islamic Schools have resulted in different implementations of the concept to the various transactions. Vogel divides the implementations of the concept of *gharar* into two main approaches.[216] These are the restrictive approach and the broader approach. According to Vogel the majority are adopting the restrictive approach.[217] An example of the restrictive approach is the prohibition by some Islamic Schools of the sale of non-existing objects at all.[218] Another Islamic School has allowed the sale of non-existing objects on the condition that the buyer has the right to reject the goods even if it fits the description.[219]

---

[208] MOHAMMAD KAMALI, ISLAMIC COMMERCIAL LAW: AN ANALYSIS OF FUTURES AND OPTIONS, at 86 (Islamic Texts Society, 2000).
[209] *Id.*
[210] *Id.*
[211] Mervyn Lewis, *'Wealth Creation through Takaful (Islamic Insurance)*, at 8 paper presented at the Islamic Wealth Creation Conference, University of Durham, July 2003 (on file with author).
[212] *Id.* at 7. *E.g.*, Islam prohibits gambling.
[213] *Id.* at 8.
[214] KAMALI, *supra* note 208, at 85.
[215] VOGEL ET AL, *supra* note 178, at 89.
[216] *Id.* at 91.
[217] *Id.*
[218] *Shaifi* School adopts this approach.
[219] *Hanafi* School supports such view.

However, the supporters of the broader approach hold the view that the sale of non-existing objects is valid on the condition that upon the production of the object: it must conform to the description.[220] Another liberal approach towards the interpretation of *gharar* has been introduced by Ibn Taymiyya who argued that *gharar* is a matter of degree.[221] Hence, if the contract involves a trivial *gharar*, the contract should be valid.[222] As will be seen, the concept of *gharar* will have implications on financial systems. Even the liberal approaches to the interpretation of *gharar* "would not countenance the conscious assumption of risk inherent in many modern financial transactions, such as derivates or insurance, or, most of all, use of these transactions for sheer speculation".[223]

4.2.3 THE SHARI'A AND INVESTORS' EXPECTATIONS IN CONVENTIONAL FINANCE

The above discussions of riba and gharar shed some light on why conventional financial transactions are in conflict with the principles of Islamic Shari'a. This does not mean, however, that Islamic Shari'a is against profit making. Thus, Islamic Shari'a differs from conventional finance in terms of the means in making the profits. Profit making is legitimate under the Shari'a as long as, inter alia, riba is not existent and gharar is eliminated. Thus, profit making is achieved through using different structures that will be outlined in the next Section.

It can be argued then that the prohibition of gharar and riba present a challenge to the investors who are used to modern finance techniques and indeed to their expectations in terms of profit-making and risk management. Thus, investors who are used to conduct their businesses using conventional finance methods have high

---

[220] VOGEL ET AL, *supra* note 178, at 93.
[221] *Id.*
[222] *Id.*
[223] *Id.*

expectations in terms of the protection available to minimise any risks. This is might be attributed to the fact that conventional financial systems and their practices are emanating from the West and predominated by the Anglo-American legal systems. The Anglo-American legal systems are pro-creditor in their nature and do grant a legal flexibility to the creditors or the financial institutions in structuring and managing the risks.[224]

In addition, the views and policies that are propagated by the major international financial institutions and discussed earlier in this Chapter add another dimension towards what "would-be" expected from a developing country or an emerging market. While this might have contributed to the high expectations of the investors, this might not be the case when one considers the Islamic Shari'a and its views which oblige the investors to undertake certain level of risk to justify any profits. Such will be further highlighted in the next Section which considers the development of "Islamic finance".

4.3 THE DEVELOPMENT OF ISLAMIC FINANCE[225]

Warde opines that Islamic countries regardless of their ideological learnings have learned to live with interest and modern finance.[226] This is true, as Islamic countries had no alternatives. In addition, the Arab and the Islamic countries with varying degrees had to borrow laws that are modelled on Western laws. In the 1970s, however, economic and political events have challenged these facts and "helped to create a more acute sense of an original Islamic identity, and a collective feeling that

[224] That is not to deny that fact that other developed countries maintain viable legal systems such as France and Germany.

[225] Most of the following discussions under this Section are based on the author's co-authored publication. *See* Amr Marar et al., *Islamic Securities Exchanges: Principles and International Developments*, *in* FINANCIAL MARKETS AND EXCHANGES LAW, (eds., Michael Blair et al., Oxford University Press, 2006).

[226] WARDE, *supra* note 165, at 49.

the *Shari'a* should guide and govern the lives of Muslims in all their daily interactions, and not be confined merely to personal and family matters. As a result, there is a growing impetus for a fresh evaluation and interpretation of the original principles of the *Shari'a*, with the aim of reasserting the *Shari'a* as a valid and reasonable corpus of commercial and civil law".[227]

In the light of this, there was a pressing need to develop an Islamic-compliant functional equivalent for the existing conventional interest-bearing financial systems. To this effect, major initiatives have been introduced and extensive researches took place to introduce an Islamic banking model which has developed later to encompass other financial sectors such as capital markets and the insurance sector. These initiatives were based on major reviews of the Islamic *Shari'a* including Islamic *fiqh* and culminated with the development of "Islamic finance". Islamic finance, therefore, is a new development and a novel financial innovation aimed at satisfying both the modern needs and their Islamic compliance.

Thus, "Islamic finance" services are based, in their objectives and operations, on the principles of the *Quran* and the *Sunna*. In this sense, "Islamic finance" is different from *conventional* finance which has no such preoccupations.[228] Also, "Islamic finance" involves more than banking and it includes investment funds, insurance, capital markets and other non-banks.[229] In providing Islamic-compliant services, Islamic financial institutions should incorporate certain Islamic principles in their operations. Hence, Islamic financial institutions should avoid *riba* and *gharar*, discussed above.

[227] Saleh, *supra* note 162, at 11.
[228] Based on Warde's definition of "Islamic financial institutions". *See* WARDE, *supra* note 165, at 5.
[229] *Id.* at 6.

Another principle that should be singled out is that, under Islamic *Shari'a* principles, any financial gain without effort or liability is prohibited.[230] Islamic *Shari'a* is not against financial gains or profits as long as an effort is performed or a partial liability is accepted.[231] This "risk-bearing" concept of Islamic finance applies to both labour and capital.[232] Thus, Islamic *Shari'a* does not allow payment to labour unless there is an effort is performed and it does not allow any reward for capital unless it is exposed to business risks.[233] In this sense, Islamic financing transactions should be based on a "risk-sharing" basis between the financier and the borrower. Islamic finance is, therefore, different from conventional finance because its structures would normally need an approval from an Islamic *Shari'a* committee for its Islamic *Shari'a* compliance.[234]

The Islamic finance industry has grown tremendously during the last decade. Islamic-compliant finance products are estimated to worth USD 500 billion and are projected to grow at 12 to 15 % per annum for the next ten years.[235] Many Islamic countries have recognised Islamic finance formally. Thus, Malaysia, as will be seen in Chapter Five, has formally recognised Islamic finance and developed a successful Islamic financial system alongside its conventional financial system. It has also introduced a viable legal framework to govern these Islamic finance activities. Other G.C.C Member States, as will also be seen later in this volume, have followed the same route.

---

[230] Diederik van Schaik, *Islamic Banking,* 3 THE ARAB BANK. REV. 45, at 46, 2001.
[231] *Id.*
[232] Ausaf Ahmed, *The Evolution of Islamic Banking,* 15, at 17 *in* ENCYCLOPAEDIA OF ISLAMIC BANKING AND FINANCE, (Institute of Islamic Banking and Finance, 1995).
[233] *Id.*
[234] Normally Islamic banks will have a *Shari'a* committee comprising of *Shari'a* scholars who will review the transaction documentations to ensure the transaction's compliance with Islamic *Shari'a*.
[235] Jamil Hamza, *Islamic Finance: An Evolving Reality in the Financial World,* THE MANILA TIMES, 14 August 2006.

The growth of "Islamic finance" is not confined to Islamic countries. Certain non-Islamic countries have already adjusted certain laws to facilitate Islamic finance transactions.[236] Other countries have licensed for Islamic bank and have expressed their interest in "Islamic finance". For example, the City of London, one of the leading international financial centres, has been witnessing recently a growing competition among major law firms, banks and insurance institutions in providing "Islamic finance" services to their clients.[237]

Given the rapid growth of "Islamic finance", there has been a need to bring the industry within the global mainstream of regulation. To this effect, various multilateral Islamic Financial Institutions and standard-setting bodies have emerged.[238] Their main objective is to contribute in building Islamic international standards and best practices as well as shaping up the "Islamic financial architecture".[239] These institutions include, *inter alia*, the Islamic Financial Services Board, the Islamic Development Bank and the Accounting & Auditing Organisation

---

[236] *E.g.*, the UK has amended certain tax-related rules to accommodate Islamic finance transactions. *See* the Finance Act (2005) and Finance Act (2006). In addition, the UK Financial Services Authority is studying introducing specific regulations to regulate Islamic finance products and has published a consultation paper to this effect. *See generally* FSA, REGULATION OF HOME REVERSION AND HOME PURCHASE PLANS, Consultation Paper 06/8, April (2006) *available at* http://www.fsa.gov.uk

[237] *E.g.*, the Securities and Investment Institute; a widely respected professional body for those who work in the securities and investment industry in the UK has introduced the "Islamic Finance Qualification". *See generally* http://www.sii.org.uk. *See also* Rodney Wilson, *Islamic Banking in the United Kingdom,* 148 NEW HORIZON 5, (2005). *See* Islamic Bank of Britain http://www.islamic-bank.com and the European Islamic Investment Bank (EIIB) http://www.eiib.co.uk/. *See also,* Editorial, *Is EIIB Thinking What UK Muslims are Thinking,* 110/111 ISLAMIC BANKER 22, (2005). Also other banks have launched Islamic products through their London subsidiaries: The Arab Banking Corporation has launched *Alburaq* Islamic products to retail customers in UK and Europe; *see* http://www.alburaq.co.uk. *See also* Mushtak Parker, *Alburaq Ascends Mortgage Ladder*, 100 ISLAMIC BANKER 18, (2004). HSBC has also launched Islamic finance products *see* http://www.hsbcamanah.com/. Also, Lloyds TSB Bank has launched its Islamic banking current account in the UK; *see* Mushtak Parker, *Lloyds TSB Launches Islamic Current Account,* 108/109 ISLAMIC BANKER 16, (2005).

[238] *See* Chapter Five for further discussion.

[239] Islamic Financial Institutions are those multilateral Islamic institutions that have been established to oversee the Islamic finance industry and to work towards its standardisation such as the Islamic Financial Services Board, Islamic Development Bank and the Accounting and Auditing Organisation for Islamic Financial Institutions. *See* Chapter Five for full discussion

for Islamic Financial Institutions. However, while these institutions have introduced various standards, their practical implementation is yet to be seen.

At this stage, it is helpful for the purposes of this thesis, to briefly introduce the main Islamic financing modes as well as other products such as Islamic *sukuk* (*i.e.,* bonds)[240] and Islamic *takaful* (*i.e.,* insurance) since these Islamic finance modes are not only used for banking transactions but are also used in structuring various Islamic-compliant capital market structures. The Islamic financing modes can be divided into two broad categories, namely, the Profit and Loss Sharing and the Non-Profit and Loss Sharing financing modes.

4.3.1 PROFIT AND LOSS SHARING FINANCING MODES (PLS)

The PLS financing modes are equity financing mechanisms. It is argued that these modes are the original mechanisms for financing under *Shari'a* and upon which Islamic financing transactions should be based.[241] There are two main contracts under the PLS financing modes. The first contract is the *musharka* or 'partnership finance', which is an equity participation contractual relationship between the parties. Under the *musharka* structure, the financier and the borrower each contribute capital and share both the profits and the losses on the basis of their share in the capital and their effort. In Islamic banking practice, *musharka* structures are used for both short- and long-term financings.[242]

The second PLS financing mechanism is the *mudaraba* or 'trust financing', which is a partnership structure whereby the investment comes from one partner (*i.e.,*

[240] *Sukuk* is the plural of *suk* which is an Arabic word meaning bond or better referred to as an Islamic investment certificate. *See* NATHIF ADAM ET. AL., ISLAMIC BONDS: YOUR GUIDE TO ISSUING, STRUCTURING AND INVESTING IN SUKUK, at 3 (Euromoney, 2004).
[241] Usmani, *supra* note 192, at xv. *See also* SAMI TAMER, THE ISLAMIC FINANCIAL SYSTEM: A CRITICAL ANALYSIS AND SUGGESTIONS FOR IMPROVING ITS EFFICIENCY, (Peter Lang, 2005).
[242] TAMIR, *supra* note 241, 83-84.

the beneficial owner of the capital)[243] and the management is the exclusive responsibility of the other (*i.e.,* the *mudarib* or "management trustee").[244] Under this structure, the Islamic bank provides the entire capital needed for the financing and shares in the profits with the borrower (*i.e.,* the management trustee) at a predetermined ratio. However, losses are entirely borne by the bank. A model of *mudaraba,* the "*two-tier mudaraba*", enables the Islamic bank to act as an intermediary between investors (depositors) and entrepreneurs (borrowers).[245]

The "*two-tier mudaraba*" structure consists of two *mudaraba* contracts: the unrestricted *mudaraba* and the restricted *mudaraba.* The Islamic bank enters into an unrestricted *mudaraba* with its depositor whereby the depositor provides the capital and the bank acts as a "management trustee" enjoying a complete and unrestricted freedom in using the funds. Then, the bank enters into a restricted *mudaraba* contract with the entrepreneur (*i.e.,* borrower). Here, the bank is acting as a "capital provider" and the entrepreneur is the "management trustee". The contract is restricted because the bank agrees to finance a specific project carried out by a specific entrepreneur.[246]

4.3.2 NON - PROFIT AND LOSS SHARING FINANCING MODES (NON-PLS)

In essence, unlike PLS financing modes, the Non-PLS financing modes are not financing mechanisms. They have, however, been adjusted and reshaped in order to be used in Islamic financing transactions. There are three main Non-PLS financing modes, namely *murabaha, istisna* and *ijara.* Unlike the PLS financing modes,

[243] Rodney Wilson, *The Issue of Interest and the Islamic Financing Alternatives,* 13(1) J.I.B.L 23, at 25, (1998).
[244] *Id.*
[245] ISLAMIC CAPITAL MARKET FACT FINDING REPORT: REPORT OF THE ISLAMIC CAPITAL MARKET TASK FORCE OF THE INTERNATIONAL ORGANISATION OF SECURITIES COMMISSIONS, at 11, July, (2004).
[246] V. SUNDARARAJAN ET AL., ISLAMIC FINANCIAL INSTITUTIONS AND PRODUCTS IN THE GLOBAL FINANCIAL SYSTEM: KEY ISSUES IN RISK MANAGEMENT AND CHALLENGES AHEAD, at 21, IMF Working Paper, November (2002).

murabaha and *istisna* are forms of Islamic debt financing and *ijara* is a form of *quasi*-debt financing.

Murabaha, or 'cost plus financing',[247] in essence, is a sale contract.[248] Under the *murabaha* structure, the bank buys the assets, which means that ownership is transferred to the bank which therefore takes certain risks associated with ownership. The bank then sells the assets to the client at a price which includes the bank's profit. The client pays for the assets in instalments over an agreed period of time. This transaction is a debt-financing mechanism because, when the bank sells the assets to the client on an instalment basis, a creditor-debtor relationship is created. The *murabaha* structure is usually used in international trade financing.

In construction or manufacturing projects, Islamic financiers have developed the concept of *istisna,* or 'commissioned manufacturing'.[249] *Istisna* is a "kind of sale where a commodity is transacted before it comes into existence. It means to order a manufacturer to produce a specific commodity for the purchaser".[250] Islamic banks enter into a "*back-to-back istisna*"[251] structure which involves two contracts. The first contract is between the Islamic bank and the manufacturer whereby the bank acts as the buyer of the manufactured assets. The second contract is between the client and the Islamic bank whereby the bank acts as the seller or the manufactured assets.

[247] Wilson, *supra* note 243, at 27.
[248] USMANI, *supra* note 192, at 37.
[249] Gohar Bilal, *Islamic Finance: Alternatives to the Western Model,* 23 Fletcher. F. World Aff. 145, 154, (1999).
[250] USMANI, *supra* note 192, at 88.
[251] Ariel Berschadsky, *Innovative Financial Securities in the Middle East: Surmounting the Ban on Interest in Islamic Law*, 9 U. MIAMI BUS. L. REV. 107, 116, (2001).

Another structure which is commonly used by Islamic banks is the *ijara*; normally referred to as 'lease financing'.[252] Under an *ijara* agreement, the Islamic bank purchases an asset and leases it to the client. Unlike conventional leasing provided by conventional banks, under the *ijara* structure, the ownership risks that are associated with the asset are borne by the Islamic bank. Some structures involve a lease purchase arrangement or *ijara wa iqitina*.[253] Under this structure a lessee will be able to purchase the leased asset at the end of the lease period.

4.3.3 ISLAMIC CAPITAL MARKET PRODUCTS

While conventional bonds are deemed non-*Shari'a* compliant due to the "interest" involved, equity securities such as shares have not attracted major criticisms from Islamic scholars because in essence they represent ownership and some element of "risk-sharing" which are in compliance with Islamic *Shari'a*.[254] However, with the development of "Islamic finance" certain Islamic finance products have been introduced to the market. The following discussion gives a brief summary of "Islamic finance" based equity securities and *sukuk*.

Ideologically, Islamic law has always encouraged equity financing. Islamic jurists, therefore, hold the view that the ownership and trading of common stock is permissible.[255] However, screening criteria have been developed as a yardstick for permissible Islamic-compliant stock investments. These criteria, although arbitrary,[256] have received recognition by many Islamic jurists and are being implemented by Islamic stock indexes. Screening is a developed practice that serves

[252] Bilal, *supra* note 249, at 154.
[253] AUSAF AHMAD, CONTEMPORARY PRACTICES OF ISLAMIC FINANCING TECHNIQUES, at 46 (IRTI, 1993).
[254] *See* Luayy Al-Rimawi, *Middle East: Islamic Models of Equity Markets,* 21 Company Lawyer 161, at 161, (2000). (arguing that because equity represents risk capital in conventional finance, Islamic jurists were prepared to accept existing equity market models instead of developing Islamic ones).
[255] TAMIR, *supra* note 241, at 108-109.
[256] *Id.* at 111.

as a benchmark in including or excluding publicly traded securities from investment portfolios based on the principles of Islamic *Shari'a*.[257]

In equity investments, the screening process can be divided into *qualitative* and *quantitative* criteria.[258] The qualitative criterion involves mentoring the activities of the investment to ensure its compatibility with the Islamic *Shari'a*. Thus, the activities of the company which has issued the stock must be permissible and Islamic-compliant.[259] This means that companies involved in non-Islamic business activities such as the distribution of alcoholic beverages would fail to meet the qualitative criterion.

The second screening criterion is the quantitative criterion which is a set of financial ratio filters. These financial ratios involve a precise measurement of the underlying investment accounts to ensure that they are *Shari'a* compliant.[260] Because Islamic *Shari'a* prohibits *riba*, the quantitative criterion involves examining the underlying investment accounts to ensure that the proportion of the investee company's income that derived from interest is minimal. In addition, due to the Islamic prohibition of interest-bearing debts, the criterion also examines the debt-to-equity finance of the underlying investment to ensure that the debt proportion is at

---

[257] F. Scott Valpey, *Structuring Islamic Equity Funds*, *in* PROCEEDINGS OF THE FORTH HARVARD UNIVERSITY FORUM ON ISLAMIC FINANCE (September 30 - October 1 2000) 263, at 264 (Centre for Middle Eastern Studies-Harvard University, 2002).
[258] Trevor Norman, *Islamic Investments Funds*, *in* ISLAMIC ASSET MANAGEMENT: FORMING THE FUTURE FOR *SHARI'A*- COMPLIANT INVESTMENT STRATEGIES, at 6 (Sohail Jaffer ed., Euromoney Books) [hereinafter ISLAMIC ASSET MANAGEMENT]
[259] TAMIR, *supra* note 241, at 109.
[260] Rodeny Wilson, *Screening Criteria for Islamic Equity Funds*, *in* ISLAMIC ASSET MANAGEMENT, *supra* note 258, 35, at 39.

acceptable levels.[261] The following are the common financial ratios that must be less than 33 per cent:[262]

1. total debt divided by trailing 12-month average market capitalization;
2. the sum of company's cash and interest-bearing securities divided by the trailing 12-month average market capitalization; and
3. accounts receivable divided by the trailing 12-month average market

It seems from the above that "Islamic finance" based equity securities are some form of "fine-tuning" rather than complete innovation. Islamic *sukuk*, on the other hand, have been introduced to provide a functional equivalent to conventional bonds because they are completely deemed to be non-*Shari'a* compliant. Thus, while a conventional bond is a loan of money creating a creditor-debtor relationship that involves "interest", an Islamic bond represents an ownership stake in an existing asset.[263] Hence, trading in Islamic bonds equates to the transfer of ownership interests while trading in conventional bonds is a sale of debt. The structures of Islamic bonds may take various forms that are based on one or combination of more than one of the Islamic financing modes discussed above. Further analysis of these structures is dealt with in Chapter Three.

4.3.4 Islamic Insurance – Takaful

One of the main objections to the business of insurance under Islamic *Shari'a* is that insurance violates the *gharar* (uncertainty) principle.[264] This is because the benefits of the insurance contracts depend on future events which are unknown at the

[261] The debt-to-equity ratios have been subject to debate. However, the advent of Dow Jones Islamic Market (DJIM) Indexes has codified the practice. *See generally,* http://www.djindexes.com/.
[262] These are the ratios applied by the Dow Jones Islamic Market Index. For a company to be included in the index, it has to meet these ratios.
[263] ADAM ET. AL., *supra* note 240, at 52.
[264] Lewis, *supra* note 211, at 11.

time of signing the agreement.[265] Thus, the insured is uncertain as to whether the payment will be paid as promised, how much is going to be, or when it is going to be paid.[266] Another objection to the insurance business is that insurance companies invest their premiums in interest-based investments.[267] Hence, insurance companies' investments are *riba*-based and contravene Islamic *Shari'a*.[268] In the light of this, an Islamic form of insurance, known as *takaful* is developed.

Takaful, which means "guaranteeing each other",[269] is a concept based on social solidarity, mutual assistance and co-operation.[270] *Takaful* is co-operative in the sense that all participants are both the insured and the insurers themselves.[271] Thus, under *takaful*, policyholders pay a periodic contribution in a collective pool and agree that in event of a covered loss, each policyholder will make a proportionate gift from his account to cover the loss.[272] Also, policyholders' contributions are invested in a manner compatible with the Islamic *Shari'a*. The *takaful* contract is based on the concept of *tabarru'* (*i.e.,* to donate or contribute).[273] Under this arrangement, policyholders agree to pay a contribution to a common pool out of which compensation is paid.[274]

4.4 ISLAMIC FINANCE IN THE GLOBAL ECONOMY

It is a truism that "Islamic finance" has developed as an alternative *means* of finance to satisfy Islamic *Shari'a* requirements, but it is fair to argue, however, that

[265] *Id.*
[266] *Id.*
[267] VOGEL ET AL, *supra* note 178, at 150.
[268] Lewis, *supra* note 211, at 12. Also it is argued that insurance is like gambling which is prohibited by the Islamic *Shari'a*.
[269] NIK THANI ET AL., LAW AND PRACTICE OF ISLAMIC BANKING AND FINANCE, at 152 (Sweet & Maxwell, 2003).
[270] *Id.*
[271] *Id.*
[272] VOGEL ET AL, *supra* note 178, at 151-152.
[273] *Id.*
[274] *Id.*

the Islamic finance industry, through its Islamic Financial Institutions and standard-setting bodies, is moving towards more integration within the global economy. This is true especially that the globe, especially after the recent financial crises, is moving towards harmonisation of financial practices and strengthening of the international financial architecture. Therefore, Islamic banks are under pressure to comply with these standards and norms.[275] Warde agrees stating: "at the international level, the major Islamic banking groups rather than trying to establish a global Islamic network that would rival the global banking system, are keen on remaining within that system…"[276]

In addition, the co-operation between Islamic banks and the international conventional banking system in terms of experience, resources, correspondent banking and management agreements has been essential towards developing the Islamic banking system which lacked resources at early stage of its development.[277] In fact one has referred to the "Islamic finance" as being "not truly independent" of the modern financial complex.[278] To this end, Islamic Financial Institutions have been co-operating with the World Bank and the IMF in shaping up their international Islamic standards.[279] This does not mean, however, undermining the main objective of the Islamic Financial Institutions which is "to achieve a full integration within global economy but at the same time to construct their institutional difference at the

[275] Kristin Smith, *Islamic Banking and the Politics of International Financial Harmonisation*, 167 *in* ISLAMIC FINANCE: CURRENT LEGAL AND REGULATORY ISSUES, at 168 (Nazim Ali ed., Harvard Law School, 2005).
[276] WARDE, *supra* note 165, at 107.
[277] *Id.* at 108.
[278] Umar Moghul et. al., *Contractual Forms in Islamic Finance Law and Islamic Inv. Co. of the Gulf (Bahamas) Ltd. V. Symphony Gems N.V. & ORS: A First Impression of Islamic Finance*, 27 FORDHAM INT'L L. J. 150, AT 151, (2003).
[279] Smith, *supra* note 275, at 175-176.

global level and to create a separate financial architecture".[280] Such special characteristics of the growing Islamic financial architecture are discussed in Chapter Five.

4.4 ISLAMIC COUNTRIES: THE PROBLEM DEFINED

In the light of the modernisation process being undertaken by most Islamic countries in developing their financial systems and securities markets, the main challenge is the reconciliation between the Islamic *Shari'a* and modern finance in order to create a viable legal system that accommodate a market-led financial system. As already mentioned, Islamic countries have learned to live with modern finance and interest prior to the development of "Islamic finance". However, with the development of "Islamic finance", Islamic countries are recognising "Islamic finance" practices. Generally speaking, it is fair to state that almost every Islamic country does have both conventional and Islamic financial activities. The interaction of these activities with the legal systems of the relevant Islamic countries have generated many issues that need to be addressed by policy makers in order to create more efficient market-led financial systems.

Thus, conventional financial activities in the Islamic countries, at varying degrees, have always been subject to legal risks caused by the inconsistencies between elements of the Islamic *Shari'a* and modern finance. Al-Rimawi explains perfectly these implications stating:

> "...*Shari'a* produces unquantifiable juridical risks that at best render "offending" modern Arab commercial legislation precarious, and at worst may result in annulling it... However, in so far as Arab countries maintain this

[280] *Id.* at 169.

incongruous dichotomy between general principles of law enshrined in *Shari'a* and particular secular laws, judicial risks will always jeopardise the certitude of modern commercial legislation."[281]

Faced with this dilemma, Al-Rimawi correctly opines that "remedying this legal contradiction...requires the political will to reconstruct Arab constitutions. Nevertheless, such a reconstruction (which may be perceived as de-Islamising its legal systems) will undoubtedly encounter many misgivings..."[282]

But even at the "Islamic finance" front, these legal risks, although at a lesser extent, are not absent. The developed "Islamic finance" practice is based on new interpretations of the *Shari'a's* primary sources. Hence, "Islamic finance" practices might face rejection and challenges when disputes arise. Nevertheless, as will be seen later in this volume, the Islamic finance community is shaping up an Islamic financial architecture and a standardisation of the Islamic finance practices to mitigate such implications.

When examining the financial systems of the Islamic and Arab countries closely, one may observe different approaches or models that have developed. Firstly, the *traditional approach* of most Arab countries is that a conventional financial system is functioning within their "positive" laws with some elements of the Islamic *Shari'a*. Under this approach fits most of the Arab countries that have both civil and commercial codes. Also, these countries are witnessing the development of "Islamic finance". Under this *traditional approach* fits other certain countries that unlike other Arab countries maintain Islamic *Shari'a* as the paramount legal system of the country. Saudi Arabia, for example, maintains a conventional

[281] Al- Rimawi, *supra* note 163, at 236.
[282] *Id.*

financial system within an Islamic *Shari'a*. In this sense, the interaction between the Islamic *Shari'a* and the conventional financial system in a country such as Saudi Arabia is more likely.

Other Islamic countries, however, have accommodated conventional financial systems in a more efficient way. Malaysia is a good example in accommodating a conventional financial system which may be attributed to the fact that Malaysia is a common law based country. In addition, Malaysia has also developed a different approach that Arab countries are trying to follow. Malaysia, as an Islamic country, has developed an Islamic financial system alongside its conventional financial system. Thus, developing a dual financial system that comprises both conventional as well as "Islamic finance" components.

Finally, in realising the importance of the financial services few Arab countries are desirous to develop this sector and in doing so these countries have adopted a new approach. The United Arab Emirates, for example, in building up the Dubai International Financial Centre (DIFC) has introduced the phenomenon of "segregation". To this effect, the DIFC is completely segregated from the U.A.E's legal system. This, is believed, grants the required confidence in the DIFC's legal framework and attracts foreign investors.

5. CONCLUSION

The discussions throughout this Chapter reveal that Islamic countries have experienced or are experiencing certain "legal unrests" resulting from the interaction between global economy trends, which require market-led financial systems, and the principles of Islamic *Shari'a*. These "legal unrests" have left certain Islamic countries with undesirable situations whereby a conventional financial system is functioning within an Islamic *Shari'a* body, such as in Saudi Arabia, and therefore jeopardising certain modern finance transactions.

The Chapter also explained, by way of given assumptions, that the requirements of a sustainable economic development are the move towards market economy, building an appropriate *rule-based* economic and financial legal infrastructures; and such infrastructures require a genuine procedural and substantive rule of law orientation. However, if the "legal unrests" continue to exist, these requirements might be undermined. To avoid such consequences, Islamic countries have developed "Islamic finance" practices in order to provide a functional equivalent of finance but at the same time to comply with Islamic *Shari'a* requirements. In addition, certain Islamic countries have developed certain models, such as in Malaysia and DIFC, which provide viable examples for other Islamic emerging markets such as Saudi Arabia.

In the light of the discussions presented throughout this Chapter and having laid the foundations, the study in this volume aims to place the Kingdom of Saudi Arabia under the "legal microscope" to analyse its legal and financial systems *vis-à-vis* the trends of global economy. In pursuing this objective, the volume firstly examines the Saudi legal and financial systems at the *macro* level highlighting its *existing de facto duality* that has resulted from the interaction between the Saudi Islamic *Shari'a* legal system and the global economy trends and which, as argued in this volume, undermines the proper functionality of the existing Saudi conventional financial system (Chapter Two). Secondly, the volume takes the investigation further by examining the impacts of this interaction at the *micro* level by focusing on securitisations (Chapter Three) and secured transactions (Chapter Four).

Finally, the thesis concludes that Saudi Arabia is one of those Islamic countries that are experiencing "legal unrests". Further, the thesis proposes that these "legal unrests" can be eliminated and a better market-led financial system can be developed if Saudi Arabia adopts a two level reform process (Chapter Five). The first level would include establishing an Islamic financial system alongside its existing conventional financial system, following the Malaysian model but also taking into consideration the international efforts by the Islamic Financial Institutions and standard-setting bodies as well as other regional efforts by the G.C.C countries. In other words, a "three-dimension" approach incorporating the national model of Malaysia, the regional efforts of the G.C.C Member States and the international efforts by the Islamic Financial Institutions.

The second level of the reform process would involve incorporating the "segregation" phenomenon as adopted by the Dubai International Financial Centre (DIFC). This would mean *segregating* the Saudi domestic conventional finance component from the overall legal system and therefore eliminating any legal risks that may arise from the interaction between the Islamic *Shari'a* and conventional finance. Such combination, is hoped, should provide an opportunity for the Saudi government to have the better of both worlds: a special and robust financial system that is well-rooted in the domestic culture and interconnected with the growing Islamic regional financial markets in the G.C.C Region and that also makes foreign investment and financing in Saudi Arabia and the Region more attractive and "secure" while making it feasible to link it into the broader "global" international financial markets.

CHAPTER TWO

SAUDI ARABIA: THE 'DUALITY' OF THE LEGAL SYSTEM AND THE CHALLENGE OF ADOPTING MARKET ECONOMY- ORIENTED, COMMERCIAL AND FINANCIAL LAWS*

CHAPTER OUTLINE

* In connection with the author's doctoral research, this Chapter has been published in two articles with the doctoral supervisor's permission. *See* Amr Marar, *The Co-operation Council for the Arab States of the Gulf,* 10(3) LAW & BUS. REV. AM. 475 (2004) and *Saudi Arabia: The Duality of the Legal System and the Challenge of Adapting Law to Market Economies,* 19 ALQ 91 (2004).

1. INTRODUCTION

In line with the global economy trends discussed in the previous Chapter, the Kingdom of Saudi Arabia like other developing countries and emerging markets is adopting new market-oriented economic policies[1] and is undergoing some form of financial sector law reform. Such policy shift is necessary in order to link the Saudi financial system regionally with the Gulf Co-operation Council (G.C.C) and internationally with the international capital markets. It also facilitates meeting the Saudi significant capital formation and sustainable economic development needs.[2] The government's strong commitment to development and financial reform are exemplified by the Saudi proactive roles at the international, regional and national levels.

Thus, the Saudi persistence to join the World Trade Organisation (WTO) despite the obstacles that encountered its membership application shows its commitment to join global economy. At the regional level, Saudi Arabia has played a leading role in the formation of the G.C.C. Additionally, at the domestic level; Saudi Arabia publishes a rolling five-year plan to achieve certain economic targets. To date, these economic plans have generated the enactment of several new economic-related laws. Yet, despite these economic plans and economic laws adopted to improve the legal infrastructure by the government, some commentators have cast doubt as to the effectiveness of the existing legal framework in Saudi Arabia *vis-à-vis* economic development.[3]

[1] *See* Section 2 *infra*.
[2] *E.g.*, Saudi Arabia will need up to $15 billion new money a year, of which 30% will come in equity. However, local banking will be able to finance only $3 billion. The difference will have to come from international capital market. *See* Nigel Dudley, *The Banker*, 2002, supplement, 23, at 24.
[3] *See, e.g.*, Monica Malik, *The Role of the Private Sector*, *in* ECONOMIC DEVELOPMENT IN SAUDI ARABIA, at 126 (Rodney Wilson ed., RoutledgeCurzon, 2004)

Being an Islamic country that maintains Islamic *Shari'a* as the paramount legal system, Saudi Arabia is undergoing certain "legal unrests" resulting from the interaction between Islamic *Shari'a* and the global economy trends. Thus, while Islamic *Shari'a* remains the paramount and primary legal system in Saudi Arabia, the government has come to allow a separate, Western-based commercial law system to function within the Islamic *Shari'a* umbrella. For instance, conventional banks are allowed to function even though that may introduce inconsistency to the overall legal system. This in turn might affect the functionality of certain financial transactions as will be seen later in this volume.

However, like other Islamic countries striving to develop their financial systems in line with the global economy trends as well as satisfying Islamic *Shari'a* requirements at the same time, "Islamic finance" activities have emerged in Saudi Arabia. Thus, the phenomenal growth of the first Islamic bank in Saudi Arabia has encouraged other conventional banks to provide Islamic banking services and in fact to convert their practices in complete compliance with the provisions of Islamic *Shari'a*.[4] It is also noted that 95 percent of consumer sales activities are carried out in a *Shari'a* compliant manner.[5] However, "Islamic finance" activities in Saudi Arabia, unlike other Islamic countries, function in the absence of formal regulatory and legal frameworks dedicated to "Islamic finance".

This Chapter explores the current Saudi financial and legal systems and highlights the implications that have resulted from the interaction between Islamic *Shari'a* and global economy at the *macro* level. It argues that the economic transformation process that the Saudi government is currently undertaking is creating

---

[4] Nathif Adam, *Converting a Conventional Retail Bank to Islamic Banking*, at 41 *in* ISLAMIC RETAIL BANKING AND FINANCE: GLOBAL CHALLENGES AND OPPORTUNITIES, (Sohail Jaffer ed., Euromoney Books, 2005).
[5] *Id.*

a *dualistic legal system* that has intended positive implications on the financial system and financial transactions, but in terms of the practical implementation may give rise to certain impediments to the establishment of a market-led financial system.

To develop an efficient financial system that is necessary for a market-economy, Saudi Arabia is advised to eliminate any uncertainties and any "legal unrests" that might result from this *existing de facto duality*. In effect, the government should consider the advisability of formally re-organising and modifying this *existing de facto duality* through legally enhancing and co-ordinating both of the legal components relating to Islamic and conventional finance. This can be achieved through implementing the "segregation" phenomenon adopted by the Dubai International Financial Centre (DIFC) which would contribute towards *segregating* the conventional financial practice from the overall legal system of Islamic *Shari'a*. Simultaneously, Saudi Arabia is advised to further develop the emerging Islamic finance component of its financial system to work alongside its conventional counterpart such as in Malaysia. In doing so, Saudi Arabia would link its financial system to the international capital markets as well as the Islamic world.

In pursuing this theme, this Chapter considers the Saudi legal and financial systems at the *macro* level and highlights the *existing de facto duality*. Essential to such discussion is to analyse the Saudi economic policies through reviewing its membership in the WTO, the economic agreements of the G.C.C in which Saudi Arabia is a member and to review the Saudi Economic Development Plans. The third Section introduces the Saudi financial system as well as the major Saudi financial institutions. The fourth Section analyses the Saudi legal system, highlighting the *existing de facto duality*. The fifth Section poses and attempts to answer the question of whether such *duality* should be maintained.

2. THE ECONOMIC POLICIES IN THE KINGDOM OF SAUDI ARABIA

The aim of this Section is to review the related economic policies approved and supported by the Saudi government. Thus, in understanding the Saudi economic orientation, one can advise what are the possible laws and legal reforms that need to be undertaken in order to facilitate the implementation of these economic policies. As will be seen, Saudi Arabia is desirous to improve and to develop its economic and financial systems. In pursing such objectives, Saudi Arabia has taken measures at different levels in order to make a positive contribution to the cause of economic development and modernisation.

At the international level, Saudi Arabia applied to join the World Trade Organisation (WTO). Also, Saudi Arabia is a participant in the G-20. The G-20 seeks "to promote an open and constructive dialogue between industrial nations and emerging markets countries on key issues relating to the international monetary and financial system and, in process, to help strengthen the international financial architecture".[6] At the regional level, Saudi Arabia is the driving force behind the establishment of the G.C.C. The economic objectives and policies of this regional integration effort should have a positive impact on the Saudi legal system. Finally, at the national level; Saudi Arabia has been undertaking major reforms in order to facilitate the implementation of its objectives.

[6] *See* http://www.g20.org /aboutg20.htm.

2.1 THE SAUDI MEMBERSHIP IN THE WORLD TRADE ORGANISATION

On 13 June 1993, Saudi Arabia applied to the WTO's predecessor, the General Agreement on Tariffs and Trade (GATT 1947), under Article XXXIII.[7] The GATT 1947 Council established a Working Party to examine the application of Saudi Arabia but no progress has been achieved. However, pursuant to the decision of the General Council of the WTO, the GATT 1947 Accession Working Party was transformed into a WTO Accession Working Party.[8] The Saudi attempt to join the WTO shows its desire to join global economy. However, during the WTO accession process, Saudi Arabia has faced certain difficulties that have delayed its membership.

Saudi Arabia as an Islamic conservative country has always had concerns in opening its markets. Prior to the full accession of Saudi Arabia to the WTO, one has argued that the Saudi application for membership is a mere containment to the globalisation forces and that Saudi Arabia had no real desire to actually join the WTO.[9] Nevertheless, Saudi Arabia has been finally acceded to the WTO on 11 December 2005. So, at the policy level it is finally settled that Saudi Arabia is willing to comply with the WTO policies and to join global economy but the practical implications of such membership are yet to be seen.

Being a member of the WTO, Saudi Arabia is under the obligation to meet the WTO standards and to this effect it has undertaken a series of commitments to further liberalise its trade regime and accelerate its integration in the world economy. This means that Saudi Arabia would apply the WTO agreements uniformly

[7] WORLD TRADE ORGANISATION, REPORT OF THE WORKING PARTY ON THE ACCESSION OF THE KINGDOM OF SAUDI ARABIA TO THE WORLD TRADE ORGANIZATION, (11 November 2005), at 1 [hereinafter REPORT ON THE ACCESSION OF SAUDI ARABIA] *available at* http://www.wto.org
[8] *Id.* at 2.
[9] Tomer Broude, *Accession to the WTO: Current Issues in the Arab World*, 32 J.W.T 147, at 154, (1998).

throughout Saudi Arabia's customs territory.[10] Saudi Arabia will also eliminate any non-tariff measures that cannot be justified under the WTO but it still maintains the right to restrict the importation and exportation of a certain number of goods and services in order to protect public morals, the life and health of the population, national security interests, *etc.*[11]

In addition, Saudi Arabia will implement the relevant WTO Agreements (*i.e.*, the Agreement on Trade-Related Aspects of Intellectual Property Rights, the Agreement on Technical Barriers to Trade and the Agreement on the Application of Sanitary and Phytosanitary Measures).[12] Financial services will be allowed to Saudi Arabia subject to certain restrictions. Thus, banks will be permitted in the form of a locally incorporated joint-stock company or as a branch of an international bank. Upon Saudi Arabia's accession, the foreign equity cap for joint ventures in banking will be increased to 60 per cent.[13] While financial services can only be provided by commercial banks, asset management and advisory services may also be provided by non-commercial banking financial institutions.

Generally, however, Saudi Arabia is facing a huge task to adapt and further develop its legal and financial systems to meet WTO requirements. Thus, Islamic *Shari'a* has always been an issue during the WTO negotiations. The Saudi representatives have had concerns that joining the WTO would jeopardise certain Islamic principles. Consider the Saudi reluctance to allow foreign insurance services into the country on the ground that insurance practices are against the principles of Islamic *Shari'a*. Prior to the Saudi membership in the WTO, the insurance industry

[10] World Trade Organisation, *WTO General Council successfully adopts Saudi Arabia's terms of Accession,* (11 November 2005), *available at* http://www.wto.org
[11] *Id.*
[12] *Id.*
[13] The previous equity cap was 49%.

in Saudi Arabia has always suffered from the lack of legal recognition for a long time, as will be seen later in this Chapter.

WTO pressures, however, necessitated the availability of well-developed insurance regulations that allow market access to Saudi Arabia. The Saudi reaction was to develop "Islamic finance" based insurance namely, "Islamic Co-operative Insurance". As a result, commercial presence of insurance companies in Saudi Arabia has become permissible provided that these companies establish a locally incorporated Islamic compliant "cooperative insurance" joint-stock company. This further highlights that developing "Islamic finance" is a trend resulting from the interaction between Islamic *Shari'a* and global economy.

2.2 Saudi Arabia as a Member in the G.C.C - The Economic Objectives[14]

The Kingdom of Saudi Arabia is a signatory to the G.C.C which was established in May 1981.[15] The G.C.C consists of six Member States: these are 1) the Kingdom of Saudi Arabia 2) The United Arab Emirates, 3) the Kingdom of Bahrain, 4) the Sultanate of Oman, 5) the State of Kuwait and 6) the State of Qatar. The main founding documents and regulations that established the G.C.C, its main organisations and its executive procedures are the G.C.C Charter, the Supreme Council Rules of Procedure, the Ministerial Council Rules of Procedure and finally the Commission for the Settlement of Disputes Rules of Procedure.

Generally, the aim of the establishment of the G.C.C can be deduced from the Charter's *Preamble*: "to effect co-ordination, integration, and interconnections

[14] For a general study on the economic objectives of the G.C.C, *see* Amr Marar, *The Co-operation Council for the Arab States of the Gulf*, 10(3) Law and Business Review of the Americas 475, (2004). Also, *see generally* http://www.gcc-sg.org/

[15] The G.C.C has four main organisations: 1) the Supreme Council, 2) the Ministerial Council, 3) the Secretariat-General and 4) the Commission for Settlement of Disputes.

between them [Member States] in all fields".[16] Following the approval of the above mentioned documents, the Member States concluded the *Economic Agreement*,[17]with the desire to "to achieve advanced stages of economic integration that would lead to a Common Market and an Economic and Monetary Union among Member States according to a specific timetable, while enhancing market mechanisms and fostering the role of the private sector...".[18]

Also, the G.C.C Member States have signed and agreed on related strategies in respect to different fields. The economic and developmental aims to be achieved as a result of these agreements and strategies are the driving force behind this regional integration effort. As Member States, including Saudi Arabia, have agreed to apply certain economic policies and to unify certain laws that meet the general aims of the G.C.C, it is more likely that these regional agreements might affect the policies and the laws of each Member State.

A general reading of the G.C.C agreements and policies shows that the economic objectives of the G.C.C is in line with the general global trends discussed in the first Chapter (*i.e.*, market-economy and liberalisation).[19] The economic objectives of the G.C.C can be found in five main documents: 1) the G.C.C Charter,[20] 2) the

[16] *See* the G.C.C CHARTER Preamble, *available at* http://www.gcc-sg.org/ [hereinafter CHARTER].
[17] The Economic Agreement December, 31, 2001, *available at* http://library.gcc-sg.org/ [hereinafter Economic Agreement]. The Economic Agreement amended and revised The Unified Economic Agreement, which was signed and approved on November 11, 1981. *See* Unified Economic Agreement, Nov. 11, 1981, *available at* http://library.gcc-sg.org/ However, art. 32(2) of the Economic Agreement states that: "[the Economic Agreement] shall supersede the GCC Economic Agreement signed in 1981..., and shall supersede equivalent provisions set forth in bilateral agreements [between Member States]".
[18] *See* the Preamble of the Economic Agreement.
[19] *See* Chapter One , Section 2.1
[20] CHARTER art. 4: "1) To effect co-ordination, integration and inter-connection between Member States in all fields in order to achieve unity between them. 2) To deepen and strengthen relations, links and areas of co-operation now prevailing between their peoples in various fields. 3) To formulate similar regulations in various fields including the following:

a. Economic and financial affairs.
b. Commerce, customs and communications.
c. Education and culture.
d. Social and health affairs.
e. Information and tourism.
f. Legislative and administrative affairs.

Economic Agreement (EA), 3) the recently revised Unified Industrial Development Strategy (UIDS)[21], 4) the amended Joint Agricultural Policy (JAP)[22] and 5) the Long-term Comprehensive Development Strategy (2000-2025) (LCDS).[23] Unlike the UIDS and the JAP, the general economic objectives can be found in the EA and the LCDS.[24]

The EA consists of nine chapters and thirty three articles. The nine chapters cover different issues related to the economic development.[25] Under the EA, the Member States are obliged to establish a customs union,[26] (*i.e.*, to bring into being the Gulf Common Market), to unify the currency among the Member States and to achieve an economic and monetary union.[27] This includes "the achievement of a high level of harmonisation between Member States in all economic policies, especially fiscal and monetary policies, banking legislation, setting criteria to approximate rates of economic performance related to fiscal and monetary stability, such as rates of budgetary deficit, indebtedness, and price levels".[28] Also, the EA obliges the

4) To stimulate scientific and technological progress in the fields of industry, mining, agriculture, water, and animal resources; to establish scientific research; to establish joint ventures and encourage co-operation by the private sector for the good of their peoples".

[21] *Unified Industrial Development Strategy* (revised version), 2000, *available at* http:// library.gcc-sg.org/ [hereinafter UIDS]. The original UIDS was adopted by the Supreme Council in 1985. However, the UIDS was revised and a new version was adopted by the Supreme Council in 1998.

[22] Joint Agricultural Policy, 1996, *available at* http:// library.gcc-sg.org/ [hereinafter JAP]. The JAP was adopted by the Supreme Council in 1985. However, the JAP was amended and the new amended version was adopted in 1996.

[23] *Long Term Comprehensive Development Strategy (2000-2025)*, 2003, *available at* http:// library.gcc-sg.org/[hereinafter *Development Strategy*] is a review of the document Development Goals, Policies and Plans for the GCC States which was adopted in 1985. However, this Chapter will be covering the Development Strategy. The economic objectives are also covered in the Development Goals, Policies and Plans for the GCC States.

[24] The *UIDS* and the *JAP* are more specific related areas of economic development.

[25] This Section does not provide a full review of the Economic Agreement.

[26] Economic Agreement, *supra* note 17, art. 1. *See also Common Customs Law for the Arab States of the Gulf* (January 2003), *available at* http:// library.gcc-sg.org/ which was adopted in 2001 by the Supreme Council; *see also Rules of Implementation of the Customs Law* (January 2003), *available at* http:// library.gcc-sg.org/.

[27] Economic Agreement, *supra* note 17, art. 4.

[28] *Id.*

Member States to unify all the investment related laws and regulations,[29] to integrate financial markets among the Member States and to unify all related legislation and policies.[30]

The EA calls for the implementation of the LCDS.[31] The main goal of the LCDS is "accomplishing sustainable and integrated development plans, imparting the necessary flexibility to serve the goals of development in each state separately and jointly at the level of the Council thereby accomplishing constant rise in the quality of life of the people in the G.C.C states and instilling the capacity to adjust with the developments of the 21st century".[32] In the LCDS, the Member States are to assess objectively the challenges facing the G.C.C in various spheres. Taking these challenges into consideration, the Member States then are to lay down certain objectives and goals to be achieved and to be implemented in order to meet these challenges.

In approving the LCDS, the Member States realises the challenges that they face in different economic and development spheres. The Member States also recognise the growing trend towards globalisation of the economy.[33] This includes freeing the international trade and investment within the framework of the WTO, quitting centralised planning, adopting decentralised planning and establishing a free market economy.[34] The LCDS ensures that Member States remove all hurdles that prevent the movement of economic resources between the Member States and re-emphasise the integrated economic partnership.[35] It also directs Member States to remove the

[29] *Id.* art. 5(1).
[30] *Id.* art. 5(3).
[31] *Id.* art. 7.
[32] *See Development Strategy*, *supra* note 23, "The Main Goal and the Strategic Objectives".
[33] *See Development Strategy*, *supra* note 23, "Second Set of Challenges".
[34] *Id.*
[35] *See Development Strategy*, *supra* note 23, "Economic Issues".

sources of vulnerability from the economic environment in the G.C.C states,[36] to ensure adequate water resources for development needs,[37] to derive maximum benefit from infrastructure facilities,[38] to build joint large-scale Gulf projects[39] and to undertake small-scale projects which will fulfil the objectives of integration between the large-scale projects.[40]

Being a signatory to the above-mentioned agreements and policies shows that the government of Saudi Arabia is willing to improve the economic infrastructure by taking measures concerning the following:[41] 1) freeing the international trade and investment, 2) adopting a market-oriented economy, 3) enacting laws which encourage foreign investors; and 4) unifying its banking and financial legalisations with other Member States of the G.C.C

2.3 THE SAUDI FIVE-YEAR ECONOMIC PLANS

The government of Saudi Arabia has realised the need for economic development long before the establishment of the G.C.C.[42] In fact, being the driving force behind the establishment of the G.C.C as a regional bloc, Saudi Arabia has been laying the foundations for a long-term economic development plan.[43] In pursing its objective of development, the government of Saudi Arabia has established the Ministry of Economy and Planning, which has various tasks including preparing the five-year

[36] *Id.*
[37] *Id.*
[38] *Id.*
[39] *Id.*
[40] *Id.*
[41] *See Development Strategy, supra* note 23, "Mechanisms for Implementing the Strategy"; *see also* mechanism (6) for implementing the *Development Strategy*; the Member states should "amend legislations, laws and resolutions, which are incompatible with efforts aimed at achieving the strategic objectives..."
[42] *See generally, e.g.,* KING FAISAL AND THE MODERNISATION OF SAUDI ARABIA, (Willard Beling ed., Croom Helm Ltd, 1980).
[43] There are other non-economic reasons behind the establishment of the G.C.C

development plans.[44] As explained in the previous Chapter, economic planning is normally associated with socialist and communist countries. Ideologically, however, planning in Saudi Arabia is not based on any of such ideologies.[45] Planning in Saudi Arabia has been a 'macroeconomic exercise' rather than a detailed 'microeconomic management'.[46] The government ensures that its planning policies do not have a great interference with the private sector.[47]

Economic planning in Saudi Arabia was first devised in 1960s. So far, there are eight economic plans each of them is covering a period of five years. This section, however, does not aim to analyse all the economic plans. Rather, the aim is to highlight the common aims shared among the economic plans and to deduce the economic orientation of the Saudi government. The basic aims that have been addressed in these economic plans include economic diversification and reduction of the Saudi dependence on oil revenues, encouraging the role of the private sector, improving the standard of living and developing Saudi human resources.

However, the recent plans reflect international and regional dimensions. This is because of the Saudi application to join the WTO and its membership in the G.C.C. In order to meet the WTO accession requirements, the Saudi government had to commit to undertake major reforms and to meet international standards. Also, being a member in the G.C.C. Saudi Arabia ensures to conform its economic policies to regional requirements of the G.C.C. The recent Saudi economic plans have taken this into consideration.

---

[44] *See generally* http://www.planning.gov.sa/

[45] *See* Wilson, *supra* note 3, at 22.

[46] *Id.* Wilson argues that planning can be implemented into four basic ways which two of them are present in Saudi Arabia namely: 1) Designing a public expenditure based on expected resources and 2) Setting targets for the economy as a whole and identifying how much will be invested in each sector. *See Id.*

[47] *Id.*

The First Development Plan covered the period 1970-1975. The main aim of the First Plan was for "Saudi Arabia to maintain its religious and moral values, and to raise the living standards and welfare of its people, while providing for material security and maintaining economic and social stability".[48] The Second Development Plan covered the period 1975-1980, a period during which Saudi Arabia witnessed significant increase in the oil revenues. The Second Plan focused on the issue of industrialisation and the establishment of two new industrial cities. This Plan also encouraged the private sector to participate in national development. In facilitating the private sector role, the government created Specialised Credit Institutions to extend credits to the private sector at favourable prices.[49]

The Third Development Plan covered the period 1980-1985. The Third Plan re-emphasised the need to diversify the Saudi economy and to reduce the dependence on the oil revenues. To support this policy, the Fourth Development Plan, which covers the period 1985-1990, laid down basic themes to restructure the national economy in order to enable the private sector to play a greater role in the country; namely, 1) greater operational efficiency, 2) increased attention to non-oil revenue-generating activities such as agriculture, industry and financial services, 3) enhanced private sector participation in economic development and 4) greater integration with neighbouring G.C.C states.[50]

The Fifth Development Plan, covering the period 1990-1995, aimed at continuing the diversification of the economy and the encouragement of the private sector involvement. The implementation of the Fifth Plan was adversely affected by the Gulf War in 1999-1991. The Sixth Development Plan, covering the period 1995-

[48] *See* Rodney Wilson, *supra* note 3, at 23.
[49] For example, Saudi Arabian Agricultural Bank, *see infra* Section 3.1.
[50] PHILIP DEW, SAUDI ARABIA: RESTRUCTURING FOR GROWTH, at 26 (Euromoney Books, 2003).

2000, introduced various new initiatives including privatisation. According to Dew, by the end of the Sixth Plan the government was successful in establishing the basic infrastructure needed to support modern economy.[51] In 1999, the government established the Supreme Economic Council (SECON) to improve the decision-making process in relation to the economic policies pursued by the government. The SECON has reaffirmed its commitment to apply the principles of free market economy.[52]

In line with its predecessor plans, the Seventh Development Plan, covering 2000-2005, "emphasised the development of the private sector within the context of a free market economy with the aim of preparing this sector to become a major pillar of economic activity".[53] So, it is a governmental policy to adopt a free market economy in Saudi Arabia where the private sector will play an important role.[54] To this end, one of the main strategies of the Seventh Plan is to accelerate the review of all regulations related to the private sector.[55]

The government in adopting the Seventh Plan realises the importance of the financial sector. It states "the mobilisation of [the] financial resources will require major steps to be taken to make the financial and non-financial investment climate in the Kingdom more attractive, particularly by improving the financial system's institutional and regulatory framework".[56] This Plan encourages commercial banks to develop their activities in order to extend credit on a long-term basis.[57] The Seventh

[51] *Id.*
[52] Wilson, *supra* note 3, at 19.
[53] *See, The Seventh Development Plan*, Chapter 7 *available at* http://www.planning.gov.sa/ [hereinafter *Seventh Development Plan*].
[54] DEW, *supra* note 50, at 28.
[55] *Seventh Development Plan, supra* note 53, Section 7.4.5 "Improving the Regulatory and Investment Environment".
[56] *Seventh Development Plan, supra* note 53, Section 7.5.1 "Role of the Financial Sector".
[57] The dominant share of lending (75%) in Saudi Arabia is on a short-term basis. *See Seventh Development Plan, supra* note 53, Section 7.5.2.2 "Commercial Banking System".

Plan, also, reflects the governmental policy towards the Specialised Credit Institutions.[58] The government believes that the role of these institutions should decline and that "lending and borrowing activities should be based on market requirements and mechanisms".[59] Hence, the Seventh Plan calls for developing the equity and capital markets.[60] Finally, the Seventh Plan lays down the following measures in order to develop the financial sector's institutional framework:[61]

- enacting a securities market law to complement the existing banking control law and the companies' law, along with the development of the capital market infrastructure in the Kingdom;
- prepare and implement an adequate framework to regulate the securities issuance operations by non-bank financial institutions, including off-shore institutions;
- develop a mechanism in order to regulate and oversee the activities of stock markets as is the case in other countries. The stock market regulatory agency should establish procedures for issuing new shares with the objective of encouraging companies to convert to joint stock companies;
- revise the regulations relating to the conversion of firms into joint stock companies; and facilitate the process of transformation, especially for innovative companies; and establish the institutional and regulatory framework to enable the private sector raise capital through the issuance of corporate bonds;

[58] The Specialised Credit Institutions are governmental institutions which provide loans for specific industries, *see infra*.
[59] *Seventh Development Plan, supra* note 53, Section 7.5.2.4 "Specialised Credit Institutions".
[60] *Seventh Development Plan, supra* note 53, Section 7.5.2.3 "Equity Capital Markets". According to the *Seventh Development Plan*, bond issuing is not available as a source of corporate finance.
[61] *Seventh Development Plan, supra* note 53, Section 7.5.3 "Development of the Financial Sector's Institutional Frameworks".

- provide facilities to ensure small and medium-sized firms' access to capital, provided that these facilities will be an integral part of the Kingdom's policies related to diversification and employment creation; and
- issue regulations aimed at encouraging commercial banks to provide real estate mortgage lending, through appropriate coordination with relevant government agencies and departments.

In addition, the Eighth Development Plan, which covers the period 2005-2009, reaffirms the Saudi willingness to develop and to improve the financial system. The main objectives of the Eighth Development Plan in respect of the Saudi financial system are to encourage and mobilise national savings to finance various economic activities,[62] to develop local capital markets and insurance services as well as raising the level of their efficiency[63] and to contribute to the improvement of the performance of the national economy including the diversification of income.[64] The Eighth Plan aims to adopt, *inter alia,* the following various policies to achieve the above objectives:[65]

- encouraging the merger of banks and expanding the establishment of specialised investment banks;
- supporting a legal framework for residential and commercial mortgages;
- supporting the financing of small and medium-scale companies;
- establishing a market for corporate bonds, including government enterprises bonds;

[62] *See, The Eighth Development Plan*, at 331 *available at* http://www.planning.gov.sa/ [hereinafter *Seventh Development Plan*].
[63] *Id.*
[64] *Id.*
[65] *Id.*

- co-operating with the G.C.C countries for the establishment of regional capital markets; and
- opening the securities market for foreign investors.

2.4 CONCLUDING REMARKS

Having reviewed the Saudi economic initiatives, it is noticeable that Saudi Arabia aims to achieve two main broad objectives. Firstly, as a member of the WTO, Saudi Arabia is desirous to join global economy and to link its financial system with the international capital markets. The Saudi government's announcement of its desire to establish the "King Abdullah Economic City"[66] in Jeddah reveals the Saudi commitment to develop the financial sector in the country. In line with these objectives, Saudi Arabia has also opened its financial services market to foreign banks to fulfil its commitments under the WTO agreements.

Secondly, Saudi Arabia aims to further enhance its integration with the neighbouring countries of the G.C.C. Thus, The Eighth Development Plan expressly provides for further integration with the G.C.C through establishing a regional capital market. Saudi Arabia is also committed to further enhance such integration in fulfilment of its commitments under the G.C.C agreements. To pursue this objective, Saudi Arabia is required to undertake certain measures in relation to its financial system in order to achieve some level of harmonisation with other member states of the G.C.C.

Unlike Saudi Arabia, however, the G.C.C Member States, as will be seen in Chapter Five, have developed "Islamic finance" related regulations. Nevertheless,

[66] Saudi Arabian General Investment Authority, *'King Abdullah Economic City' launched by Custodian of The Two Holy Mosques'*, 20 December 2005 *available at* http://www.sagia.gov.sa. *See also* http://en.wikipedia.org/wiki/King_Abdullah_Economic_City.

Saudi Arabia has expressed its intention to develop "Islamic finance" activities within its financial system. Thus, the Eighth Development Plan expresses the Saudi desire in developing an Islamic mortgage system.[67] Additionally, Saudi Arabia is also under the obligation to consider the enactment of "Islamic finance" regulations under the G.C.C agreements. Thus, the G.C.C agreements call for some level of harmonisation among the G.C.C banking and finance legislations. Presumably, this would include "Islamic finance" legislations.

Meeting the entire economic objectives mean that Saudi Arabia would be able to attract foreign capital and investments. Such are needed to achieve a broader goal, namely; diversifying the economy (*i.e.,* non-oil economy).[68] To this effect, Saudi Arabia is in the process of developing other sectors and industries. The Saudi government has already taken certain steps to facilitate this process. For example, building a viable investment infrastructure has been a major focus for the Saudi government.[69] To oversee this process, the government has established the Saudi Arabian General Investment Authority (SAGIA).[70]

SAGIA seeks to improve the investment climate in Saudi Arabia and report any suggested reforms to the Supreme Economic Council[71] which is the top economic policy making body in Saudi Arabia. In 2005, SAGIA has issued licenses for 642 foreign and joint-venture projects with an investment capital of Saudi Riyal 202

[67] *Eight Development Plan, supra* note 62, at 320.
[68] Diversification of the Saudi economy is one of the main priorities on the Saudi agenda. *See* SAUDI ARABIAN MONETARY AGENCY, FORTY-SECOND ANNUAL REPORT (2006), at 36 [hereinafter ANNUAL REPORT (2006)] *available at* http://www.sama.gov.sa/
[69] *See* ANNUAL REPORT (2006), *supra* note 68, at 36. (refers to the improvement of the investment environment as one of the priorities).
[70] *See generally* http://www.sagia.gov.sa/.
[71] *See generally* http://www.sec.gov.sa/

billion, involving 174 licenses for industrial projects and 466 licenses for service projects.[72]

Presumably, these policies and objectives lay the foundations for an efficient market-economy in Saudi Arabia. However, as discussed in the previous Chapter, this policy shift necessitates a *rule of law orientation* and a *rule-based financial system*. But, a major challenge for Saudi Arabia is to adapt its existing legal system to market economies. It is the aim of the rest of this Chapter to review the financial and legal systems of Saudi Arabia and to identify the potential challenges.

3. THE FINANCIAL SYSTEM IN SAUDI ARABIA

It is helpful to undertake an overview of the overall financial system in Saudi Arabia before going into a deeper examination related to its legal foundations. The Saudi government is taking major steps in order to upgrade its existing financial system and to meet the challenge of adopting a market economy. Although Saudi Arabia has a large financial system, "its development remains constrained by restrictions in Islamic law and a tradition of secrecy in corporate affairs".[73] As discussed in the previous Chapter, Islamic *Shari'a* prohibits the charging of interest. Arguably, these religious sensibilities have also contributed to the underdevelopment of the debt securities market in Saudi Arabia.[74] These issues will be further illustrated in the rest of this Chapter: the following, however, is a general overview of the Saudi financial system.

[72] *See* ANNUAL REPORT (2006), *supra* note 68, at 36
[73] THE ECONOMIST INTELLIGENCE UNIT, COUNTRY FINANCE: SAUDI ARABIA, at 7 (January, 2004).
[74] *Id.*

3.1 THE BANKING SECTOR

The banking system in Saudi Arabia comprises four main elements:[75] 1) the Saudi Arabian Monetary Agency (SAMA); 2) the government-owned Specialised Credit Institutions; 3) the commercial banks; and 4) the money exchangers.[76] SAMA is the central bank[77] of Saudi Arabia. The main objectives for establishing SAMA as laid down in the establishing Charter are:[78] 1) to issue and strengthen the Saudi currency and to stabilise its internal and external value; 2) to deal with the banking affairs of the Government and 3) to regulate commercial banks and exchange dealers. Clearly, SAMA is the supervisory authority of the commercial banks and the exchange dealers.[79] All commercial banks and money exchangers are required to render to SAMA statements of their financial status on a monthly basis.[80]

As mentioned, the Saudi government upon the adoption of the Second Development Plan decided to create Specialised Credit Institutions that will contribute in providing the needed credit for specific developmental sectors. To this effect, the government established the following five Specialised Credit Institutions:

1) The Saudi Arabian Agricultural Bank:[81] the bank was established in 1961[82] to provide low-cost finance for agricultural projects.

[75] Dew, *supra* note 50, at 46. Dew refers to these four elements to as constituting the financial system in Saudi Arabia. We preferred the term banking to exclude capital markets and the insurance sector.
[76] The money exchangers are outside the scope of this study.
[77] Interestingly, when SAMA was first established the Saudi King refused that SAMA is referred to as 'bank' or 'financial agency'. *See* Wilson, *supra* note 3, at 59.
[78] CHARTER OF THE SAUDI ARABIAN MONETARY AGENCY, Royal Decree No. 23, December 15, 1957, art. 1[hereinafter CHARTER OF SAMA]
[79] *Id.* art. 1(c) and art. 3(d). Recently, however, as will be seen *infra* SAMA is the responsible body for supervising the insurance sector.
[80] CHARTER OF SAMA, art.3(d).
[81] *See generally* http://www.saab.gov.sa
[82] Saudi Arabia Agricultural Bank Law, Royal Decree No. 58, 1961.

2) The Real Estate Development Fund: the Fund was established in 1974[83] to encourage urban development and the construction of private residential houses.

3) The Saudi Industrial Development Fund:[84] the Fund was founded in 1974[85] to provide medium-term and long-term funding for private sector industrial projects.

4) The Public Investment Fund: the Fund was established in 1971[86] to provide medium-term and long-term financing for "commercially oriented public corporations".[87]

5) The Saudi Credit Bank: the Bank, which was created in 1973,[88] is the smallest Specialised Credit Institution. It provides personal loans to Saudi individuals.

However, lending by these institutions has declined since the mid-1990s.[89] This reflects the governmental policy which is stated in the Seventh Development Plan. The government's desire to move towards a market-based economy explains the decline in the lending activities by these government financial institutions.

In addition, there are private commercial banks that operate in Saudi Arabia. Unlike the Specialised Credit Institutions which are capitalised by the government, the commercial banks are privately-owned.[90] Commercial banks include Islamic and

[83] Real Estate Development Fund Law, Royal Decree No. M/23, 1974.
[84] *See generally* http://www.sidf.gov.sa
[85] Saudi Industrial Development Fund Law, Royal Decree No. M/3, 1974.
[86] Public Investment Fund Law, Royal Decree No. M/48, 1971.
[87] *Supra* note 73, at 14
[88] Saudi Credit Bank Law, Royal Decree No. M/44, 1973.
[89] *Supra* note 73, at 12.
[90] One of these private banks ; the National Commercial Bank is 50% owned by the Saudi government through the Public Investment Fund (40%) and the General Organisation for Social Insurance (10%). *See id*, at 7.

non-Islamic conventional banks.[91] Currently, there are twelve incorporated commercial banks in Saudi Arabia. In addition, SAMA has granted licences to ten foreign banks (including G.C.C banks) to operate in Saudi Arabia. Half of these banks are already operating and the rest are expected to begin soon.[92] SAMA believes that there should be mergers and consolidations between local banks in order to build a bigger and stronger banking sector capable of competing at international levels.[93]

Both commercial Islamic and conventional banks are under the supervision of SAMA. Islamic banks offer Islamic-compliant financial services that are based on certain Islamic concepts as discussed in Chapter One.[94] Saudi Arabia is considered to be the biggest market for Islamic finance in size.[95]

3.2 THE CAPITAL MARKET

The capital market refers to the market of both equity and debt securities. Recently, the Saudi government is endeavouring to expand the role of the non-banking financial intermediation in order to facilitate and to encourage the

---

[91] Even conventional non-Islamic banks have "Islamic windows" and offer Islamic-compliant financing.
[92] SAMA granted licences to the following G.C.C banks: 1) Gulf International Bank (operating), Emirates Bank (operating), 3) National Bank of Bahrain (licensed but not operating), 4) National Bank of Kuwait (operating) and 5) Muscat Bank (licensed but not operating). Also, SAMA granted licences to the following foreign banks: 1) Deutsche Bank (operating), 2) BNP Paribas (operating), 3) J.P. Morgan Chase (licensed but not operating), 4) National Bank of Pakistan (licensed but not operating) and 5) State Bank of India (licensed but not operating).
[93] *Id.*
[94] For a general study on Islamic modes of financing *see* MUHAMMAD USMANI, AN INTRODUCTION TO ISLAMIC FINANCE (Kluwer Law International, 2002). *See also,* NIK THANI ET AL., LAW AND PRACTICE OF ISLAMIC BANKING AND FINANCE (Sweet & Maxwell, 2003). Islamic finance concepts are being structured to provide different types of financing including project finance and securitisation. On Islamic project finance *see* REINHARD KLARMANN, ISLAMIC PROJECT FINANCE: A LEGAL STUDY WITH PARTICULAR REFERENCE TO THE LAWS OF SWITZERLAND AND THE UNITED ARAB EMIRATES (Schulthess, 2003). On Securitisation see Chapter Four.
[95] Islamic finance in Saudi Arabia is the biggest in size. *See* PHILIP MOLYNEUX ET AL., BANKING AND FINANCIAL SYSTEMS IN THE ARAB WORLD, at 116 (Palgrave Macmillan, 2005). Islamic banking activity is concentrated in the G.C.C countries which account for 83 % of the total assets of Islamic banks. Saudi Arabia is the largest market for Islamic finance in terms of seize; the largest Islamic bank in the world is located in Saudi Arabia namely; Al Rajhi Banking and Investment Corporation.

mobilisation of capital.[96] Such will play a pivotal role in the privatisation process and in the shift to market economies. Saudi Arabia has the largest stock market by capitalisation in the Arab world[97] and the second largest in the Islamic world after Malaysia.[98] The Saudi market capitalisation as of end-November 2006 was USD 341.65 billion.

However, two elements have affected the growth of the Saudi stock market. Firstly, the availability of government finance through its Specialised Credit Institutions which offer loans with zero interest.[99] Secondly, the dominant 'family business' mentality within the Saudi businesses.[100] Such mentality prevents Saudi companies from listing in the market. As for bonds and debt securities, the market is still not very developed due to religious sensibilities.[101] According to the Seventh Development Plan, bond issues were not available as a source of corporate financing.[102]

Prior to 2003, SAMA was the regulatory agency of the stock market. However, with the promulgation of the new Capital Market Law in 2003, a new regulatory authority is established: namely, the Capital Market Authority, taking over the role of SAMA in supervising and regulating the issuance and trading of securities. The law also establishes for the first time a trading floor, namely, the Saudi Stock Exchange which is the sole entity authorised to carry out trading in securities in Saudi Arabia. Whether such regulatory and legal frameworks contribute in enhancing and strengthening the Saudi capital markets will be discussed in this Chapter.

---

[96] BANK FOR INTERNATIONAL SETTLEMENTS, THE BANKING SYSTEM IN EMERGING ECONOMIES: HOW MUCH PROGRESS HAS BEEN MADE?, BIS Papers No. (28), August (2006), at 331.
[97] DEW, *supra* note 50, at 65.
[98] Wilson, *supra* note 3, at 67.
[99] Wilson, *supra* note 3, at 67.
[100] *Id.*
[101] *Supra* note 73, at 7.
[102] *See supra* note 60.

3.3 THE INSURANCE SECTOR

The dominant players in the Saudi financial system are the banks. Other financial players have marginal role.[103] Insurance companies in Saudi Arabia offer traditional insurance services.[104] The insurance sector in Saudi Arabia can be divided into two: 1) the General Organisation for Social Insurance (GOSI).[105] The GOSI is a state-owned entity and it is responsible for providing pensions to the Saudi workforce. 2) The rest of the insurance market comprises companies that are privately owned. As will be seen further in this Chapter, insurance transactions have been viewed to be against Islamic law. Hence, insurance companies have been circumventing these legal prohibitions by registering the company in a neighbouring G.C.C state and running a branch in Saudi Arabia.[106]

However, one insurance company has not faced such dilemma: the so-called National Company for Co-operative Insurance (NCCI).[107] The NCCI is owned by the government and enjoyed monopoly over government related business. The reason for its legality is the fact that it operates according to Islamic *Shari'a* principles.[108] However, the new insurance law provides official recognition for the Saudi insurance sector in the Kingdom and requires all the conventional insurance companies to transfer its operations in a manner similar to the NCCI.[109]

---

[103] *Supra* note 73, at 14.
[104] *Id.*
[105] *See generally* http://www.gosi.co.sa/
[106] *Supra* note 73, at 14.
[107] *See generally* http://www.ncci.com.sa. The NCCI is a joint stock company established in Riyadh, Saudi Arabia by Royal Decree Number M/5, 1985.
[108] *See* The Articles of Association: The National Company for Co-operative Insurance *available at* http://www.ncci.com.sa/EN/About%20Us/Establishment/AoA%20E.pdf. Art. 3 states the purpose is: "To transact cooperative insurance operations and related activities, such as reinsurance or agency activities, provided that such activities are in conformity with Islamic *Shari'a*...". However, whether co-operative insurance is an Islamic insurance similar to the *takaful* concept applied in Malaysia has been questioned. *See* Dawood Taylor, *Is Co-operative Insurance Akin to Takaful?*, 97 ISLAMIC BANKER 8, (2004). *See also* Mushtak Parker, *Is Co-operative Insurance Islamic?*, 84 ISLAMIC BANKER 6, (2003). *See* Chapter Five on Islamic *Takaful* in Malaysia.
[109] *See* the discussion *infra*.

4. SAUDI ARABIA: THE DUALITY OF THE LEGAL SYSTEM

4.1 THE CONCEPT OF DUALITY: SEARCHING FOR A DEFINITION

Prior to discussing the Saudi legal system in depth in order to highlight the *existing de facto duality*, this Subsection endeavours to define what is meant by the term 'duality'. A general definition of 'duality' or dualism is "the division of something conceptually into two opposed or contrasted aspects".[110] So, duality of the legal system could mean the existence of opposing and contrasting aspects, norms, principles and substantive laws within the same legal system. This may lead to the existence of a dual judiciary or two court systems.[111] Each court system has jurisdiction over certain type of law. As discussed in the previous Chapter, Hooker explains why 'legal pluralism' or duality might exist within a legal system.[112] He argues that duality exists when a state voluntary adopts a certain law which is borrowed from another.[113] Hence, the duality is created simply because "the original [law] is by no means displaced in whole or in part by the introduced law".[114]

Such a conclusion is of relevance to the developing countries and emerging markets. Countries that are moving towards market-economy and willing to deepen and strengthen their financial and legal systems such as Saudi Arabia, will be inclined to borrow certain laws from the developed countries. In doing so, and without adapting the existing law, Saudi Arabia is creating a dual legal system. The dualistic nature of the legal system is reflected by the existence of Islamic and other "positive" laws.

---

110 THE CONCISE OXFORD DICTIONARY, at 440 (Judy Pearsall ed., Oxford University Press, 1999).
111 *See, e.g.,* Nizar Hamzeh, *Qatar: The Duality of the Legal System,* 30(1) MIDDLE EASTERN STUDIES 79, (1994).
112 The term 'duality' is preferred to be used in this volume to denote the existence of only two opposed norms within the same legal system which are going to be further identified in this Chapter.
113 *See* Chapter One.
114 BARRY HOOKER, LEGAL PLURALISM: AN INTRODUCTION TO COLONIAL AND NEO-COLONIAL LAWS, at 3 (Clarendon Press, Oxford, 1975).

Nabil explains this situation in the Arab world stating that: "The Egyptian and Arab cases have had many...legal dualities and shortcomings historically, and still have. We dare not say pluralism lest it may imply a legal coexistence and peace among legal systems which are philosophically, referentially and functionally contradictory in so far as effectiveness and applicability to legal relations are concerned, not to mention their applicability to the contradictory legal centres in society. There is a duality within the official legal system itself between secular, western references and purely religious references".[115]

Clearly, the above statement refers to the duality as existing within the "official legal system". Hence, such duality is a synonym to state legal pluralism.[116] Moving from general to particular, Vogel gives an excellent description of the duality in the Saudi legal system stating that:

> "In most Islamic states other than Saudi Arabia, the legal system is bifurcated: one part is based on man-made, positive (*wadi*) law; the other part on Islamic law. The first part usually exists in the form of comprehensive codes similar to those of the European civil law systems, and the second in the form of Islamic law, usually codified as well. The positive legal system provides the basic or residual law, while the Islamic law is exceptional, supplementary and relatively narrow in scope. There is a similar bifurcation in the institutions that apply the law, for example, between positive law tribunals and religious law courts.
>
> Saudi Arabia also has a dual legal system, but the relative roles of the two sides are reversed. The Islamic component of the legal system is

[115] Nabil Abd Al-Fattah, *The Anarchy of Egyptian Legal System: Wearing Away the Legal and Political* Modernity, *in* LEGAL PLURALISM IN THE ARAB WORLD, at 159 (Baudouin Dupret et al. eds., Kluwer Law International, 1999).

[116] In the above statement, Nabil, uses the term duality rather than pluralism explaining that pluralism might imply coexistence and peace among legal systems. However, the author's discussions of "legal pluralism" in Chapter One did not show neither expressly nor implicitly that the term 'pluralism' implies coexistence and peace. However, the author has suggested that there could be "legal pluralism" that maintains the "rule of law". In this respect, the term "duality" and "pluralism" are used interchangeably for the purposes of this thesis.

> fundamental and dominant. The positive law, on the other hand, is subordinate, constitutionally and in scope".[117]

The above statement explains correctly the status of the Saudi legal system and highlights the *existing de facto duality* in Saudi Arabia, which is analysed further in this Chapter. It is in the light of Vogel's statement that one should examine the financial and legal systems in Saudi Arabia. Thus, the existence of a conventional financial system within the Islamic *Shari'a* has generated many "legal unrests" as to executing financial transactions. These "legal unrests" continue to exist because there is always an interaction between Islamic *Shari'a* and conventional financial transactions. On the other hand, "Islamic finance" is growing in Saudi Arabia. This, as explained in Chapter One, reflects the general growing trend in the Islamic countries, being the development of "Islamic finance" as a *means* to contain the "legal unrests" generated by the interaction between Islamic *Shari'a* and modern finance.

An example for such trend in Saudi Arabia is the conversion of the Saudi insurance sector into an Islamic-compliant sector to circumvent the "legal unrests" that have always been caused as a result of the interaction between the conventional insurance practice and Islamic *Shari'a* as explained later in this Chapter. The current status of the Saudi financial system can be summarised as follows:

1. There is an existing conventional finance component that interacts with the overall Islamic *Shari'a* (*i.e.* a system *within* a system). This is the *existing de facto duality*.

[117] Frank Vogel, *Islamic Governance in the Gulf: A Framework for Analysis, Comparison, and Prediction*, *in* THE PERSIAN GULF AT THE MILLENNIUM: ESSAYS IN POLITICS, ECONOMY, SECURITY, AND RELIGION, 249, at 275-276 (Gary Sick et al. eds., Macmillan Press Ltd, 1997).

2. There is a growing "Islamic finance" component within the Saudi financial system, including the conversion of the Saudi insurance market into an Islamic-compliant sector. This "Islamic finance" component is not rule-based or regulated by special "Islamic finance" laws or regulations in line with the growing trend followed by certain Islamic countries and promoted by the major International Islamic Financial Institutions as will be discussed later in this volume.

The aim of the rest of this Chapter is to analyse further the *existing de facto duality* referred to above. It will also explain its implications on the Saudi legal system. Arguably, there are historical reasons for this *existing de facto duality*. Hence, a brief historical background is helpful.

4.2 HISTORICAL BACKGROUND

The Kingdom of Saudi Arabia is a recent state established in 1932 when Ibn Saud[118] declared himself as the King of Saudi Arabia.[119] The King unified the main five regions under one Kingdom[120] namely:[121] *Najd*,[122] *Al-Hasa, the Hijaz* (Western Region),[123] *Asir*, and the Northern Region. Unlike other Arab countries in the Middle East, the Kingdom of Saudi Arabia has not been colonised by Britain or any other Western country.[124] However, there was a paramount British influence during the first three decades of the twentieth century.[125] Prior to the annexation of the Western

[118] King Abd al-Aziz ibn Abd al-Rhman Al Saud, referred to him as Ibn Saud.
[119] MADAWI AL-RASHEED, A HISTORY OF SAUDI ARABIA, at 2 (Cambridge University Press, 2002).
[120] MORDECHAI ABIR, SAUDI ARABIA: GOVERNMENT, SOCIETY AND THE GULF CRISIS, at xv (Routledge, 1993).
[121] *Id.*
[122] The Central Region of the Kingdom of Saudi Arabia.
[123] The Western Region is considered to be the most important as the two Holy Cities for the Muslims are located in this region (*i.e.* Mecca and Medina)
[124] ABIR, *supra* note 120, at 2.
[125] *Id.*

Region in 1932, the Western Region used to be under the control of the Ottoman Empire.[126] As such, the Western Region has been affected by the Ottoman's law.

The Ottoman Empire used to apply Islamic law until 1839.[127] In 1839 onwards, reforms took place by introducing the *Tanzimat*.[128] *Tanzimat*, which mean 'ordering' or to put things in order,[129] did not replace Islamic law, but was introduced in addition to it.[130] The Ottomans introduced laws which are copied from Europe and in particular France.[131] Several laws had been introduced, for example, criminal law of 1840, commercial law of 1850 and civil procedure law of 1880.[132] At the same time, the Ottomans worked on the codification of some of the Islamic laws, namely the laws related to civil transactions[133] the so-called the *Majalla*, referred to in Chapter One, or according to Hooker, the Civil Code.[134]

These reforms, which had been taking place in the Ottoman Empire, along with the application of the Islamic law at the same time, has caused state legal pluralism and is one of the case studies that have been examined by Hooker.[135] The resulting situation is described as follows: "Modern Turkish legislation falls roughly into two classes: the codes genuinely intended for home consumption, and those of which the primary aim is to satisfy the foreigner, and to support the claim of Turkey to equal

126 However, the population in the Hijaz was reluctant to accept the Ottoman control at that time. *See* JUSTIN MCCARTHY, THE OTTOMAN PEOPLES AND THE END OF EMPIRE, at 83 (2001, Arnold Publishers).
127 MUHAMMAD ABDUL JAWAD, ESSAYS IN ISLAMIC *SHARIA* AND LAW, at 29 (Munshat Almaref, 1977) [In Arabic].
128 JUSTIN, *supra* note 126, at 16.
129 *Id.*
130 HOOKER, *supra* note 114, at 362.
131 ABDUL JAWAD, *supra* note 127, at 29.
132 *Id.* at 29-30.
133 *Id.* at 30.
134 HOOKER, *supra* note 114, at 363.
135 *Id.* at 360. One of the reasons mentioned by Hooker for state legal pluralism is the voluntary adoption of Western laws as a means of social and economic reform.

international treatment".[136] In addition to these changes, new courts were established to apply the new adopted laws leading to a duality in the judicial organisation.[137] The result is that Ottomans had two court systems namely; the "*Tanzimat* Courts" to apply the new *Tanzimat* and the "Islamic *Shari'a* Courts" to apply Islamic law.[138]

The adoption of Western laws, along with the application of the Islamic law in the Ottoman Empire, had arguably, laid the foundations for a dual legislative as well as judicial systems in all the territories that fell under its control.[139] Hence, this duality has been passed to the Western Region or *Hijaz*, because it was under the direct control of the Ottoman Empire and which is currently a part of Saudi Arabia.[140] However, when the Western Region had been taken over by King Ibn Saud in 1925 and became part of the Saudi Kingdom, the King stated that the Ottoman laws would still apply in the Western region.[141] Thus, the duality, which did not exist in the Saudi legal system prior to the inclusion of the Western Region, had been passed to the Saudi legal system and the rest of the Kingdom.[142]

4.3 THE LEGAL SYSTEM IN SAUDI ARABIA

It is a plausible argument that there are historical roots for the *existing de facto duality* in the Saudi legal system. However, since the discovery of oil in the Kingdom, there was a need to enact new laws to accommodate the resulting new economic changes. Accordingly, many laws were passed, and especially laws related to the commercial sector because it was the main concern for the Kingdom. So, the

---

[136] *Id.* at 362, (referring to Ronald Wilson, *'Modern Ottoman Law'*, 8 J. COMP. LEG. & INT'L. L. 41, 41, (1907).
[137] ABDUL JAWAD, *supra* note 127, at 31.
[138] *Id.*
[139] *Id.*
[140] MUHAMMAD ABDUL JAWAD, THE LEGISLATIVE DEVELOPMENT IN THE KINGDOM OF SAUDI ARABIA, at 66 (Munshat Almaref, 1977) [In Arabic].
[141] *Id.* at 44.
[142] *Id.* at 69.

duality in the Saudi legal system should not be only seen as a continuation of the past caused by historical reasons upon the annexation of the Western region; but also, other reasons play a very important role.

Thus, the recent policy shift towards adopting market-oriented policies and the government's desire to activate the private sector's participation in the national economy have necessitated the enactment of further specific laws that would facilitate fulfilling such aims. As this Chapter explains, the enactment of these laws has caused the *existing de facto duality* in the legal system in Saudi Arabia.

4.3.1 THE PARAMOUNT LEGAL SYSTEM IN SAUDI ARABIA

The paramount legal system in Saudi Arabia is the Islamic *Shari'a*.[143] The Kingdom has been described as the "most traditionalist Islamic legal system" nowadays.[144] This is clear from the constitution of the Kingdom.[145]Article 1 of the constitution states: "The religion of Saudi Arabia is Islam; its Constitution is the *Book of God Most High* and the *Sunna* of His Prophet...".[146]Also, Article 7 of the Constitution provides that the "government in Saudi Arabia derives power from the *Holy Quran* and the Prophet's tradition".[147] Islamic *Shari'a* provides the 'cultural

[143] FRANK VOGEL, ISLAMIC LAW AND LEGAL SYSTEM: STUDIES OF SAUDI ARABIA, at 2 (Namara Publications, 2000). *Shari'a,* sometimes referred to as *Shariah,* is an Arabic word which means the path to be followed and literally means the way to a watering place. *See* ABDUR RAHMAN DOI, *SHARIAH:* THE ISLAMIC LAW, (Ta Ha Publishers, 1987). The jurisprudential meaning of *Shari'a* is the regulations and rules made by God for his mankind to follow. *See* ABDUL AL-SALAM ET AL., AN INTRODUCTION TO LEGISLATION PRINCIPLES IN SAUDI ARABIA, at 9 (Dar El-Ketab El Jameae, 1983) [in Arabic]. It can be referred to as the common law of Islam, *see* WILLIAM BALLANTYNE, ESSAYS AND ADDRESSES ON ARAB LAWS, at 33 (Curzon Press, 2000).
[144] VOGEL, *supra* note 143, at xiv.
[145] The term constitution is not used in Saudi Arabia as it is believed that the Holy *Quran* is the constitution of Kingdom. Hence, the Saudi government has deliberately avoided the term constitution. Instead the constitution has been referred to as *Nisam Assasy*, which means the Basic System or the Basic Regulation, and was promulgated in 1992. For more on the constitutional reforms in Saudi Arabia *see* Rashed Aba-Namay, *The Recent Constitutional Reforms in Saudi Arabia*, 42 INT'L & COMP. L. Q. 295, (1993).
[146] CONSTITUTION OF SAUDI ARABIA, March 1992, art. 1 *available at* http://www.the-saudi.net/saudi-arabia/saudi-constitution.htm [hereinafter SAUDI CONSTITUTION]
[147] *Id.* art. 7.

milieu' for the development of the legal system in Saudi Arabia[148] and it is considered by most of the Saudis as their 'indigenous law'.[149] As mentioned in Chapter One, there are four main Islamic schools. The predominant school in the Saudi legal system is the *Hanbali* School, but this does not mean casting aside the rest of the Islamic schools as they can also be considered.[150]

Because Saudi Arabia applies Islamic *Shari'a* as the paramount legal system, Islamic *Shari'a* courts have the general and higher jurisdiction. However, as discussed in detail below, there are certain exceptions. Article 26 of the Judiciary Law states: "Courts shall have jurisdiction to decide with respect to all disputes and crimes, except those exempted by law. Rules for the jurisdiction of courts shall be set forth in the *Shari'a* Procedure Law Courts and Law of Criminal Procedure. Specialised Courts may be formed by Royal Order on the recommendation of the Supreme Judicial Council".[151] Judges of the Islamic *Shari'a* courts apply Islamic *Shari'a*; article 1 of the Judiciary law states: "Judges are independent and, in the administration of justice, they shall be subject to no authority other than the provisions of *Shari'a* and laws in force. No one may interfere with the Judiciary".[152]

However, Islamic *Shari'a* courts are not to be considered the only entities to adjudicate disputes. The second entity is the Board of Grievances which has jurisdiction over disputes where one of the government agencies is involved. In other

---

[148] Nicholas Angell, *Impact of the GCC on the Developing Legal Systems of the Gulf Countries, in* THE GULF COOPERATION COUNCIL: MODERATION AND STABILITY IN AN INDEPENDENT WORLD, at 149 (John Sandwick ed., Westview Press, 1987). Sometimes the Islamic *Shari'a* is referred to as the 'common law'. *See also* Enid Hill, *'Comparative and Historical Study of Modern Middle Eastern Law'*, 26 Am. J. Comp. L. 279, at 280 n. 4 (1977-1978).
[149] VOGEL, *supra* note 143, at xiv.
[150] ABDUL JAWAD, *supra* note 140, 75-88. *See also* NAYLA COMAIR-OBEID, THE LAW OF BUSINESS CONTRACTS IN THE ARAB MIDDLE EAST: A THEORETICAL AND PRACTICAL COMPARATIVE ANALYSIS WITH PARTICULAR REFERENCE TO MODERN LEGISLATION, at 156 (Kluwer Law International, 1996).
[151] The Law of Judiciary, Royal Decree No. M/64, 23 July 1975, art. 26 *available* http://www.moj.gov.sa [hereinafter Judiciary Law].
[152] Judiciary Law, *supra* note 151, art. 26

words, the Board of Grievances is specialised in judicial review. As will be seen, the jurisdiction of the Board has expanded to encompass other areas of laws (for example, commercial law disputes).[153] Thirdly, there are specialised committees that deal with different areas of law and are discussed later in this Chapter.

4.3.2 THE IMPLICATIONS OF ISLAMIC SHARI'A ON THE SAUDI FINANCIAL SYSTEM

Being the paramount legal system of Saudi Arabia, Islamic *Shari'a* has influenced certain Saudi laws that are related to the commercial and financial systems. Thus, consider article 2 of SAMA's Charter, which states that: "The Saudi Arabian Monetary Agency shall not pay nor receive interest but shall only charge certain fees on services rendered to the public and to the Government, in order to cover the Agency's expenditures".[154] Also, article 6(a) of the Charter states that SAMA shall not act: "in any manner which conflicts with the teachings of the Islamic law. The Agency shall not charge any interest on its receipts and payments".[155]

SAMA is not the only entity that does not deal with interest. Thus, the Specialised Credit Institutions established by the government are not allowed to charge interest in their loan transactions. Nevertheless, it can not be concluded that Saudi Arabia maintains an 'interest-free' banking system. The commercial banking in Saudi Arabia is partly a *de facto* interest-based system.[156] However, when executing loan agreements the term 'commission' is used instead of interest.[157] Nevertheless, commercial banks have had difficulty in enforcing the payment of interests,

[153] *See* the discussion *infra*.
[154] CHARTER OF SAMA, *supra* note 78, art. 2.
[155] *Id* art. 6(a).
[156] DEW, *supra* note 50, at 46.
[157] NABIL SALEH, UNLAWFUL GAIN AND LEGITIMATE PROFIT IN ISLAMIC LAW, at 6 (Graham & Trotman, 1992).

especially in the 1980's.[158] The reason is that Islamic *Shari'a* courts have never accepted the idea of enforcing interests due to its prohibition under Islamic *Shari'a*. Hence, many defaulting borrowers took advantage of that to avoid paying interests charged by banks.[159] This, in turn, has affected the availability of financing to small firms due to the reluctance of commercial banks to provide such financing in the absence of a legal system that enforces their rights.[160]

Despite the government's response to solve this problem,[161] the issue of charging interest in Saudi Arabia is still unclear, Al-Dukheil writes: "the issue of payment of interest by the commercial banks continues to remain a grey area in the country's legal framework. Religious-minded people's aversion to the word 'commercial' in banking nomenclature continues to be a major drag on the ability of the commercial banks to act as mobilisers of savings in the Saudi household".[162]

Islamic *Shari'a* has also its implications on the Saudi insurance sector. Thus, as explained in Chapter One, Islamic scholars maintain the view that insurance is against Islamic *Shari'a* due to the Islamic *Shari'a* prohibition of *gharar*.[163] As a result and prior to the new insurance law, insurance companies were unable to register in Saudi Arabia due to the illegality of their operations. These examples, *inter alia*, show the implications of the Islamic *Shari'a* on, but not limited to, the Saudi financial system.[164]

[158] ABDULAZIZ AL-DUKHEIL, THE BANKING SYSTEM AND ITS PERFORMANCE IN SAUDI ARABIA, at 50 (Saqi Books, 1995).
[159] *Id.*
[160] *Id.*
[161] The Saudi government established the Committee for Settlement of Banking Disputes. *See* the discussion *infra*.
[162] *Id.* 50-51.
[163] *See* Chapter One.
[164] Islamic law is the dominant law in Saudi Arabia. Hence, the implications are not only upon the existing financial system but also in all other sectors and areas of law. Consider, for example, Article 6 of the Saudi Negotiable Instruments Regulations, which states: "any stipulation of interest in the bill

These implications may not be viewed positively from a conventional finance perspective. However, the need of finance in modern economy and given the implications of Islamic *Shari'a*; "Islamic finance" has emerged, as indicated earlier, to create a balance in providing the necessary financial services while complying with the *Shari'a* requirements. Such *Shari'a*-compliant products were instigated due to the implications of the Islamic *Shari'a* on the Saudi conventional finance component. The following discussion shows how the Saudi government is dealing with the interaction between the conventional finance component and Islamic *Shari'a*.

4.3.3 THE MODERNISATION OF THE SAUDI LEGAL SYSTEM

The inconsistencies between many of the conventional commercial, banking and financial practices with the principles of the Saudi Islamic law have led the Saudi government to take certain measures in order to enhance the efficiency of and to ensure the certainty of the overall Saudi legal system. Another aim has been to keep pace with the ongoing economic development in Saudi Arabia: here, the Kingdom is in need to accelerate the financial and legal infrastructures in order to meet its economic demands. To this effect, certain commercial and financial laws were introduced, the so called; Regulations or "*Nizams*".[165]

Vogel describes: "In Saudi Arabia, the world's most traditional Islamic country the laws applied in explicitly commercial matters, such as companies, banking and commercial paper law strongly resembles French and Egyptian laws".[166] Hence, a

of exchange shall be null and void". *See* Negotiable Instruments Regulation, Royal Decree No. M/37, February 1964, art. 6 *available at* http://www.commerce.gov.sa (in Arabic).

[165] For the purposes of this thesis, the term "law" or "regulation" will be used interchangeably.

[166] FRANK VOGEL ET AL, Islamic Law and Finance: Religion, Risk, and Return, at 50 (Kluwer Law International, 1998).

duality in the legal system has been created because the general legal system of Islamic *Shari'a* by no means has been displaced in whole or in part by these laws.[167]

4.3.3.1 The Saudi Commercial Law and Commercial Disputes

One of the laws that have contributed to the existence of the duality in the Saudi legal system was the enactment of the Commercial Court Regulations (CCR) in 1932.[168] The CCR contained six hundreds and thirty three articles dealing with various areas including companies, bills of lading, and money exchangers. The CCR established the commercial court with jurisdiction to hear commercial disputes.[169] Thus, despite the existence of the Islamic *Shari'a* courts and an Islamic law body, there were other regulations governing commercial transactions. However, in 1954 the commercial court was abolished.[170] No express reasons were given for such decision, but one has argued that there was a pressure that commercial transactions should be heard by the original and normal courts (*i.e.,* Islamic *Shari'a* courts).[171] Thereafter, Islamic *Shari'a* courts regained their jurisdiction over commercial transactions disputes.

However, at that time, *Shari'a* courts were inexperienced to deal with disputes related to trademarks.[172] Hence, *Shari'a* courts were not prepared to hear such cases. Faced with such dilemma, the Ministry of Commerce established the Commercial Disputes Settlement Board (the "Commercial Board").[173] According to the Resolution, the Commercial Board is competent to hear all commercial disputes just

---

[167] These laws have not displaced Islamic *Shari'a* because it is still functioning within the Islamic *Shari'a*.
[168] Commercial Court Regulations, Royal Decree No (32), June 1931 *available at* http://www.commerce.gov.sa [hereinafter Commercial Regulations] (in Arabic).
[169] *See generally* Commercial Regulations, *supra* note 168, arts 432 – 587.
[170] Muhammad Al-Sheikh, *Pluralism of the Commercial Judicial Committees: Reasons, Consequences and Solutions*, 21(3) JOURNAL OF LAW 233, at 241 (1997) (in Arabic).
[171] *Id.* at 242.
[172] *Id.*
[173] *Id.* at 243.

like its predecessor (*i.e.,* the commercial court).[174] Despite these measures that aimed to improve the judiciary and ensure its efficiency, in order to keep pace with the rapid improvements and development that Saudi Arabia was undergoing, there was insufficiency of substantive laws that dealt with specific areas of laws such as company law regulations. In light of this, the government passed the Company Regulations in 1965.[175] This law provided for the establishment of a new committee to deal with any disputes governed by the Company Regulations. However, in order to avoid the conflicts between the jurisdiction of the Commercial Board and the new committee established by the Company Regulations, it was agreed that one committee should be established with the competence to hear all commercial related disputes including those related to Company Regulations.[176]

Strangely, the new committee, namely; the Commercial Disputes Settlement Committee (CDSC) had branches in three main cities in Saudi Arabia only. This meant that the settlement of commercial disputes in accordance with the CDSC laws and regulations is only possible in these three cities.[177] Similar commercial disputes in other cities were governed by the Islamic *Shari'a* and adjudicated by the Islamic *Shari'a* courts.[178] Such position was unsatisfactory and the Ministerial Council had to transfer the competence over commercial disputes to the Board of Grievances, which would be competent to hear commercial disputes in all areas of the Kingdom on temporary basis until the establishment of a new commercial court.[179] Such court,

[174] *Id.*
[175] Company Regulations, Royal Decree No M/6, July 1965 *available at* http://www.commerce.gov.sa (in Arabic).
[176] Al-Sheikh, *supra* note 170, at 243.
[177] *Id.* at 245-246.
[178] *Id.*
[179] *Id.* at 246.

however, has not been established yet, and the *status quo* remains that the Board of Grievances is the entity which has the jurisdiction over commercial disputes.

4.3.3.2 The Saudi Banking Law and Banking Disputes

Saudi Arabia has taken two major legal steps in relation to its banking sector during the 1960's and 1980's. Such steps have added the legality to the banking sector, or in other words have provided the basis for a legal framework which within the banking sector can function. However, it should be noted that such regulations have not provided any substantive banking law. Thus, there are no detailed laws dealing with day-to-day banking transactions.[180] The first law was the Banking Control Law (BCL), which was promulgated in 1966.[181] This law was a governmental response to the banking problems faced by the government in 1960. At that time, the government had intervened in order to prevent one of the Saudi banks from becoming insolvent. The government, through SAMA, intervened by injecting fresh capital and acquiring 38% of the shares of the bank.[182]

As mentioned above, the influence of the Islamic law has clear implications on the Saudi financial system in regards to the interest issue. Nevertheless, the BCL provides a legal basis for a conventional banking system within the general Islamic law of Saudi Arabia. The BCL consists of twenty six Articles that deal mainly with the regulation of banks in Saudi Arabia. It defines a bank as "any natural or juristic person practising any of the banking business in the Kingdom".[183] According to the BCL, banking business means: "the business of receiving money on current or fixed

---

[180] ABDUL-MAJEED ABDU, THE BANKING SYSTEM IN THE KINGDOM OF SAUDI ARABIA, at 15 (Mahad Al-Edara, 1406H): arguing that there is a 'legislative vacuum' in relation to the banking law in Saudi Arabia.
[181] The Banking Control Law, Royal Decree No. M/5, June 1966 *available at* http://www.sama.gov.sa [hereinafter BCL].
[182] Wilson, *supra* note 3, at 59.
[183] BCL, *supra* note 181, art. 1(a)

deposit account, opening of current accounts, opening of letters of credit, issuance of letters of guarantees, payment and collection of cheques, orders, or payments orders and similar other papers of value, discounting of bills, promissory notes and other commercial papers, foreign exchange business and other banking business".[184]

The existence of such law is of great importance in any country which is desirous to maintain a strong robust banking system. However, in the case of Saudi Arabia, the law only acknowledges, to an incomplete extent, the existence of a conventional banking system. The law does not address the interest issue; but, as noted above, Saudi commercial banks do charge *de facto* interest in most of their banking transactions. In fact, it is argued that certain provisions of the BCL are in contradiction with the "Islamic finance" concept of *musharka*.[185] This is because the BCL prevents the Saudi banks from owning "stocks of any other joint-stock company incorporated in the Kingdom, in excess of ten percent of the paid-up capital of such company".[186] Such provision was not of main concern to the banks at that time as they did not offer Islamic products.[187] However, Islamic banks in Saudi Arabia do offer Islamic financing products based on the *musharka* concept despite its inconsistency with the above-mentioned BCL provision.[188]

The consequences of the BCL's existence as a law defining the business of the commercial banks in Saudi Arabia within the general Islamic law became clear in 1980s. Wilson describes: "There was ... reluctance to repay loans on time on the part of unscrupulous businessmen, some of whom cited the Islamic prohibition of *riba* to justify their delays and evasions despite the fact that they had been fully aware of the

[184] *Id.* art. 1(b).
[185] Wilson, *supra* note 3, at 59.
[186] BCL, *supra* note 181, art.10(4).
[187] Wilson, *supra* note 3, at 60.
[188] *See generally* http://www.alrajhibank.co.sa

terms of the funding at the time the loans were taken out".[189] Clearly, the main reason is that such loan agreements have been transacted within an Islamic law body. Borrowers took an advantage of the ambiguities in the legal system in order to avoid performing their obligation under the agreements.[190]

Faced with such dilemma,[191] the government had to take an action in order to maintain the efficacy of the Saudi legal system and not to discourage the commercial banks from providing loans and financing to the private sector. In the light of this, the government established the Committee for Settlement of Banking Disputes (CSBD) in 1987.[192] The main aim for the establishment of the CSBD is to take banking disputes away from the Islamic *Shari'a* courts, which took strict position regarding the interest issue. As will be seen, the establishment of the CBSD is one of the measures that are creating a duality within the Saudi legal and judicial systems.

The law establishing the CBSD is a Resolution issued by the Prime Minister, which instructs all the Saudi courts (*i.e., Shari'a* courts) and other committees[193] not to deal with any banking related dispute unless there is an authorisation from the Ministerial Council.[194] This has been emphasised by a Circular issued by the Minister of Justice to this effect.[195] The implementation of both the Resolution and the Circular has constrained the competence of the Islamic *Shari'a* courts over

[189] Wilson, *supra* note 3, at 59.
[190] Al-Dukheil, *supra* note 158, at 50.
[191] Also the courts procedures for the banks lasted long and became expensive. Extension of time favoured to the debtor. *See* Rolf Meyer-Reumann, *The Banking System in Saudi Arabia*, 10(3) ALQ 207, at 230, (1996).
[192] Prior to the establishment of the CSBD the Saudi Ministry of Commerce issued a Ministerial Resolution No. (822), 1985 requiring all banking disputes to be referred to the Legal Committee of the Ministry. However, this Resolution has not been implemented. *See* Meyer-Reumann, *supra* note 191, at 232.
[193] Committees which deal with the commercial disputes.
[194] Resolution No. 729/8, 10 March 1987, art. 1 [hereinafter CSBD Resolution]. The CSBD Resolution has been translated by the author. The original Arabic copy does not refer to the term "Article"; instead numbers has been used as points. However, the term "Article" will be used here for convenience.
[195] "Judicial Circular to All Courts: Very Urgent" (in Arabic): a Circular of the Minister of Justice, No. 12/138 of 28 March 1987.

banking disputes.[196] Thus, the CBSD has exclusive competence to hear banking disputes.

Of the composition of the CBSD, the Resolution states that the CBSD should have three members who are specialised in banking matters. Their task is to settle the disputes between banks and their customers and to find suitable solutions for both parties according to the agreements signed between them.[197] The CBSD has been granted a wide degree of discretion.[198] This is clear from the Resolution, which gives the CBSD the power to decide what measures can be taken in order to guarantee the settlement of such disputes:[199] the CBSD can take measures such as preventing the debtor from leaving the Kingdom or freezing the debtor's money accounts.[200] While the Resolution did not address expressly disputes where the bank is the debtor, it is presumed that the CBSD will have jurisdiction over such disputes because of its exclusive competence.[201]

However, there is a confusion regarding the competence of the CBSD resulting from the formulation used in the Resolution. The Resolution states that, in case the CBSD fails to reach a satisfactory settlement between the disputed parties, the dispute should be referred to the "competent court holding original jurisdiction power"[202] (*i.e.,* Islamic *Shari'a* courts). However, an important point has been emphasised by the Secretary-General of the CBSD,[203] in accordance with the

[196] Meyer-Reumann, *supra* note 191, at 232.
[197] CSBD Resolution, *supra* note 194, art. 2.
[198] Meyer-Reumann, *supra* note 191, at 233.
[199] CSBD Resolution, *supra* note 194, art.3.
[200] *Id. See also* the Rules of the Internal Procedures of the CBSD 1407, No. 3/86620 [hereinafter Rules of CBSD] (in Arabic). Art. 6 of the Rules of CBSD give the right to the debtor to complain before the CBSD regarding the freezing injunction during 15 days. Art. 7 of the Rules of CBSD states that the CBSD has competence to hear from other creditors regarding the frozen accounts.
[201] Meyer-Reumann, *supra* note 191, at 233. *See also* Richard et al., *'The SAMA Committee Breaks New Ground on Jurisdiction'*, September MEER 22, (1988).
[202] Meyer-Reumann, *supra* note 191, at 234. *See also* CBSD Resolution, *supra* note 194, art. 7.
[203] Meeting with Dr. Ahmed Al-Saleh, Secretary-General of the CBSD on 28 April 2004.

wording of the Resolution, is that the CBSD is the entity which decides whether the dispute should be referred to the "competent court holding original jurisdiction" or not and it is not left to the discretion of the disputed parties.[204] In practice, the CBSD does not refer the disputes to the "competent court holding original jurisdiction".[205] However, there is no higher court or committee to hear appeals against the decisions of the CBSD.[206]

Having explained that, it can be argued that allowing the conventional banking system to function within an Islamic law body has resulted in a duality in the Saudi judicial body. The Islamic *Shari'a* courts were not prepared to approve non-Islamic practices such as charging of interest by the banks. The government had to establish such a committee in order to enhance the credibility of the Saudi legal system. Yet, a simple reading of the Resolution shows inconsistencies, which again reflect the duality caused as a result of the need to adapt the law to market-economies and to have a judicial body which meets the requirements of a modern financial system.

Impliedly, there is a duality in the wording of the Resolution itself. Thus, while the Resolution has established the CBSD with an exclusive competence to hear banking disputes, it instructed the CBSD to refer cases to the "competent court holding original jurisdiction" (*i.e.,* Islamic *Shari'a* courts) in case the CBSD fails to reach a satisfactory settlement between the parties. Such clause has led one to argue that the CBSD is neither a court nor a judicial body.[207] In fact, certain entities have

[204] *See also* MAHMMOD AL-KATEEB, RULES OF BANKING DISPUTES SETTLEMENT IN THE KINGDOM OF SAUDI ARABIA, at 12 (Dar Al-Kateeb, Saudi Arabia)(In Arabic).
[205] *Supra* note 203.
[206] Zuheer Al-Harbash, *'The Judicial Competence of the Banking Disputes in Saudi Arabia'*, Teegarat Al-Riyadh (Commerce in Riyadh Magazine), No. 397, October 1995, 66, at 68. (In Arabic).
[207] Meyer-Reumann, *supra* note 191, at 233. Interestingly, the wording of the establishing Resolution is pro-settlement. Thus, it instructs the CBSD to refer the dispute to the "competent court holding original jurisdiction" in case it failed to reach a "satisfactory settlement between the parties". We find such formulation inconsistent with the great discretion and powers given to the CBSD which force the debtor to be obliged to settle.

hesitated to implement the decisions taken by the CBSD.[208] In turn, the Saudi Deputy Minister of Interior had to issue a Circular instructing the enforcement entities to accelerate the enforcement of the CBSD decisions with no delays.[209]

It can be argued that the legal duality resulting from the measures taken by the Saudi government to reform the Saudi banking sector is exemplified by different facts: 1) the existence of a conventional banking system that charges interest within an Islamic law body; 2) the establishment of the CBSD to settle banking disputes within an Islamic judicial system; and 3) the settlement of disputes between banks and their debtors in accordance with the agreements executed between the parties within an Islamic law body. Thus, if the borrower has agreed with the bank that the borrower should pay certain amount of interest for the loan provided by the bank, the CBSD will attempt to enforce the outstanding amount according to the agreement signed despite the Islamic prohibition.[210] However, the CBSD might reach a satisfactory settlement between both parties regarding the outstanding amount. The establishment of the CBSD may have achieved its purpose in circumventing Islamic *Shari'a* courts in regards to banking disputes but detaching such disputes from the overall Islamic *Shari'a* is still questionable.[211]

4.3.1.3 The Saudi Capital Market Law and Securities Disputes

[208] In Saudi Arabia, the police has civil rights department to enforce civil rights. Some of these departments have hesitated to enforce the decisions taken by the CBSD.
[209] Circular by the Deputy Minister of Interior No. 10207 (1988) (In Arabic).
[210] It is argued that the CBSD will enforce the agreements even it is in conflict with the Islamic *Shari'a* law. *See* Michael McMillen, *'Islamic Shari'a-Compliant Project Finance: Collateral Security and Financing Structure Case Studies'*, 24 FORDHAM INT'L L. J. 1184, at 1215, (2001).
[211] The jurisdiction of the CBSD is quite limited. For example, for the dispute to be heard by the CBSD, at least one of the litigants needs to be a commercial bank. *See* Al-Harbash, *supra* note 206, at 68. However, the CBSD does not hear cases where the Specialised Credit Institutions mentioned *supra* are involved. This is self-explanatory since the Institutions do not charge interest. *See* Circular of the Ministry of Economy and Finance No. 17/4129 (3/9/1408 H).

As mentioned earlier, the debt securities market in Saudi Arabia is not very well-developed due to religious sensibilities.[212] Unlike the debt securities market, equity securities are acceptable. The reason is because acquiring equity is not illegal under Islamic *Shari'a*.[213] As equity capital represents risk capital:[214] it shares the same concept of risk-sharing under Islamic finance law.[215] However, as expressed in the Saudi Development Plans, the current trend is to develop both the debt and equity securities markets in the light of the new market-oriented economic reforms and policies adopted by the Saudi government.[216]

In 2003, the government enacted the long-awaited Capital Market Law (CML),[217] described as the 'big bang' of Saudi finance.[218] One of the main features of the CML is to create a capital market authority to regulate the securities sector. The CML established the Capital Market Authority (CMA),[219] which is responsible for issuing rules and for implementing the provisions of the CML.[220] The CMA's main task is to act as the regulatory authority over activities concerning the issuance and trading in securities.[221] The CMA is also responsible to develop procedures to reduce the risks related to securities transactions,[222] to protect the investors and citizens from unfair and unsound practices,[223] to achieve fairness, efficiency and transparency in

[212] *See supra* p. 52.
[213] Lu'ayy Al-Rimawi, *'Middle East: Islamic Models of Islamic Markets'*, 21(5) Company Lawyer 161, at 163, (2000).
[214] Equity holders are the last to be paid in case of insolvency. *See* ROSS CRANSTON, PRINCIPLES OF BANKING LAW, at 326 (Oxford University Press, 2002).
[215] Wilson, *supra* note 3, at 23: "the participatory nature of Islamic finance implies risk sharing, which is seen as highly desirable"
[216] *See supra* Section 2.
[217] Capital Market Law, Royal Decree Number M/3, July 2003 *available at* http://www.cma.org.sa [hereinafter CML].
[218] *Supra* note 73, at 13.
[219] CML, *supra* note 217, art. 4(a).
[220] *Id.* art. 5(a).
[221] *Id.* art. 5(a)(2).
[222] *Id.* art. 5(a)(1).
[223] *Id.* art. 5(a)(4).

securities transactions and to regulate and monitor the full disclosure of information regarding securities.[224]

Another feature of the CML is to establish an official market for the trading in securities. In this connection, the Saudi Stock Exchange (SSE), a joint-stock company, was established as the sole entity authorised to carry out trading in securities in Saudi Arabia.[225] The objectives of the SSE is to ensure fair, efficient and transparent listing requirements,[226] to provide reliable and rapid settlement procedures through its Securities Depository Centre,[227] to establish and enforce professional standards for brokers and their agents[228] and to ensure the financial strength and soundness of the brokers.[229] The CML also deals with matters related to the regulation of broker activities,[230] disclosure,[231] and insider dealings.[232]

The term "securities" is defined, *inter alia*, by the CML as:[233] 1) convertible and negotiable shares of companies and 2) bonds and other negotiable instruments of debt issued by companies, the government, public institutions or public organisations. The definition of securities does not only include equity securities, which presumably do not have any conflict with the Islamic *Shari'a*, but does cover debt securities such as bonds. The CML is again creating a duality within the Saudi legal system by allowing debt securities to function within an Islamic law body.

---

224 *Id.* art. 5(a)(6).
225 *Id.* art. 20(a).
226 *Id.* art. 20(c)(1).
227 *Id.*art.20(c)(2). The Securities Deposit Centre is a department established as the sole authority which is authorised to practice the operations of deposit, transfer, settlement, clearing and registering ownership of securities traded in the SEE. *See id.* art. 26(a).
228 CML, *supra* note 217, art. 20(c)(3).
229 *Id.* art. 20(c)(4).
230 *Id.* Chapter Five.
231 *Id.* Chapter Seven.
232 *Id.* Chapter Eight.
233 *Id.* art. 2. *See also id.* art. 3 of the CML excluded cheques, bills of exchange, order notes, documentary credits, money transfers, instruments exclusively traded among banks and insurance policies.

In addition, the Saudi government has realised that any dispute resulting from transactions that involve debt securities cannot be referred to the Islamic *Shari'a* courts. Therefore, the issue has been dealt with in a manner tantamount to the banking disputes settlements process. However, unlike the Resolution which established the CBSD, the CML uses clearer provisions to establish the Committee for the Resolution of Securities Disputes (CRSD) with jurisdiction over any dispute resulting from the implementation of the CML.[234]

The CML gives the CRSD the power to settle all disputes,[235] to issue *subpoenas*, to issue orders, to impose sanctions and to order the production of evidence and documents.[236] The CRSD is to consist of legal advisors who are specialised in matters related to securities, finance and commercial affairs.[237] In addition, the CML provides for an Appeal Panel which can hear appeals filed against the CRSD decisions.[238] The Appeal Panel has discretion to review the decisions of the CRSD, to affirm such decision and to undertake a *de novo* of the legal action or complaint.[239] The decisions of the Appeal Panel are final.[240]

Following the enactment of the CML, the CMA has introduced sets of rules in line with its objectives to further enhance the regulation of the Saudi capital market. These laws are: the Listing Rules,[241] the Securities Business Regulations,[242] the Authorised Persons Regulations,[243] the Market Conduct Regulations[244] and the

[234] CML, *supra* note 217, art. 25(a).
[235] *Id.*
[236] *Id.*
[237] *Id.* art. 25(b).
[238] *Id.* art. 25(f).
[239] *Id.* art. 25(g).
[240] *Id.*
[241] The Listing Rules, Royal Decree M/30, October (2004) *available at* http://www.cma.org.sa
[242] The Securities Business Regulation, Royal Decree M/30, June 2005 *available at* http://www.cma.org.sa
[243] The Authorised Persons Regulations, Royal Decree M/30, Junes 2005 *available at* http://www.cma.org.sa

Regulations of Offers of Securities.[245] Currently, two consultation drafts have been circulated by the CMA, namely; the Investment Funds Regulations Consultation Draft[246] and the Corporate Governance Consultation Draft.[247]

Unlike certain G.C.C member states,[248] the CMA has not issued any Islamic finance specific regulations that deal with the issuance of Islamic securities (*i.e. sukuk*). However, having allowed for the issuance of Islamic securities in Saudi Arabia; it can be argued that the CMA has already recognised the concept of Islamic securities.[249] Furthermore, as mentioned earlier, the Saudi Eighth Development Plan expressed the Saudi objective in creating an Islamic mortgage system. Such system can be enhanced through developing the "Islamic securities" system which would facilitate the availability of financing for the Saudi real estate demands.[250]

Having summarised the recent legal developments of the Saudi capital market, it can be concluded that the enactment of the CML is a positive step towards maintaining an efficient and well-supervised capital market. Practically speaking, the implications of the CML in general and the CRSD in specific on the Saudi capital market is not yet clear as the law and the entities that support it have only become fully functional at the end of 2004. However, it is the author's opinion that such law has contributed in creating the *existing de facto duality*. The establishment of CRSD is one reason but the lack of a supporting legal framework is another. Since the CML is supervisory in nature, the Islamic *Shari'a* as the paramount legal system still interact with securities-related transactions; as further elaborated in Chapter Three.

---

[244] The Market Conduct Regulations, October (2004) *available at* http://www.cma.org.sa.
[245] The Regulations of Offers of Securities (2004) *available at* http://www.cma.org.sa.
[246] Investment Funds Regulation (Consultation Draft) *available at* http://www.cma.org.sa.
[247] Corporate Governance (Consultation Draft) *available at* http://www.cma.org.sa.
[248] *See* Chapter Four.
[249] *E.g.*, CMA has authorised the issuance of Islamic *sukuk* recently. *See e.g.*, OFFERING CIRCULAR, SAUDI BASIC INDUSTRIES CORPORATION, 3 July 2006.
[250] *See* Chapter Three for further discussion on "Islamic securities".

4.3.1.4 The Saudi Insurance Law and Insurance Disputes

The insurance sector in Saudi Arabia is a good example that highlights the "legal chaos" in Saudi Arabia. As mentioned earlier, the insurance sector in Saudi Arabia was unregulated until the enactment of the Law on Supervision of Cooperative Insurance Companies (LSCIC) in 2003.[251] Prior to the promulgation of the LSCIC, the existence of a conventional insurance sector within the Islamic Shari'a had contributed towards the existing de facto duality. Conventional insurance companies were functioning within an Islamic law body which does not approve their practices. This is why insurance companies, as mentioned earlier, could not obtain commercial registration to carry out insurance business.

Also, this has caused obstacles in relation to the insurance disputes. Because insurance has been considered to be against the practices of Islamic *Shari'a*, the Islamic *Shari'a* courts were not prepared to deal with any disputes that were related to the conventional insurance business. Thus, insurance contracts could not be enforced through the Saudi courts.[252] Even in case of litigation, there was no coherent body of law which could be used as reference by the litigant parties.[253] Until late 1985, cases involving insurance transactions were resolved by an internal procedure of the Ministry of Commerce.[254] From late 1985, the Ministry of

[251] Law on Supervision of Cooperative Insurance Companies, Royal Decree No. M/32, September 2003 *available at* http://www.sama.gov.sa [hereinafter LSCIC]
[252] Andreas Haberbeck, *Insurance under Saudi Arabian Law*, 2 LLOYD'S MARITIME AND COMMERCIAL LAW 246, at 247-48, (1986).
[253] *Id.* at 248.
[254] *Id.* A hearing will take place and then the matter will be referred to the legal department of the Ministry for a decision. However, cases involve subrogation of claims used to be referred to the Committee for the Settlement of Commercial Disputes. *See Id.*

Commerce has decided that the insurance disputes should be referred to arbitration[255] in accordance with the Saudi Arbitration Law.[256]

These "legal unrests" that have been caused by the *existing de facto duality* have led the Saudi government to stabilise the insurance legal framework through legally recognising the Saudi insurance practices. To this effect, Saudi Arabia introduced the LSCIC. The LSCIC calls for the *islamisation* of the insurance sector and requires that all insurance practices should comply with the Islamic *Shari'a*.[257] The LSCIC states that: "Insurance in the Kingdom shall be undertaken through registered insurance companies operating in a cooperative manner as it is provided within the article establishment of the National Company for Cooperative Insurance promulgated by Royal Decree M/5... and in accordance with the principles of Islamic *Shari'a*".[258]

The implications of the LSCIC on the current practice of the Saudi insurance sector are clear. All the existing conventional (*i.e.*, non-Islamic) insurance companies are required by the new law to convert their operating techniques in accordance with the Islamic *Shari'a* principles.[259] The main objectives of the LSCIC[260] are to protect the rights of insured parties and investors, to encourage fair and effective competition, the provision of better insurance services with competitive prices and

---

[255] Haberbeck, *supra* note 252, at 248.
[256] Arbitration Regulations, Royal Decree No. M/46, April 1983 *available at* http://www.commerce.gov.sa
[257] However, this was the aim of the government which was stated in the Fifth Development Plan and aimed to introduce two changes to the Saudi insurance sector namely; the merger of the small private insurance companies into large co-operative insurance company working according to the Islamic *Shari'a* and the creation of a re-insurance industry.
[258] LSCIC, *supra* note 251, art. 1.
[259] Insurance companies are required to operate in a manner similar to the NCCI (*i.e.*, co-operative insurance). However, the similarity of co-operative insurance to the Islamic insurance *takaful* has been questioned. *See supra* note 108.
[260] The Implementing Rules for the Law on Supervision of Cooperative Insurance Companies, art. 2 *available at* http://www.sama.gov.sa [hereinafter Implementing Rules]

coverage, to strengthen the stability of the insurance market and to develop the insurance sector in Saudi Arabia.

Also, the LSCIC has provided that a committee should be established in order to hear disputes between insurance companies and their clients.[261] To this effect, the Insurance Committee was established. Also, the Insurance Committee deals with cases that might result from violations of the regulatory and supervisory instructions issued to both insurance and reinsurance companies.[262] The decisions of the Insurance Committee could be appealed against before the Board of Grievances.[263] SAMA has set a deadline for conventional insurance companies to comply with the LSCIC and to transfer all its operations in compliance with Islamic co-operative insurance.[264]

From the above discussion, it appears that duality existed through the provision of conventional insurance services within an Islamic law body; and arbitration was the only way to resolve insurance disputes. The question, however, is whether the LSCIC has abolished the existing duality in relation to the insurance sector in Saudi Arabia. By stating that insurance practices should conform to the principles of Islamic *Shari'a*, the LSCIC seems to be in line with the overall Islamic *Shari'a* of Saudi Arabia.

The shift towards the concept of Islamic insurance which is based on "Islamic finance" related principles shows the Saudi appetite for recognising gradually

[261] LSCIC, *supra* note 251, art. 20. The committee also hears disputes related to the subrogation of rights.
[262] LSCIC, *supra* note 251, art. 20.
[263] *Id.* However, other type of cases related to the insurance can be heard by the Board of Grievances; for example disputes between insurance and reinsurance companies. *See Id.* art. 22.
[264] The deadline was 29/12/2004. *See* "Important Notice and Directives from the Saudi Monetary Agency to the Public and Existing Companies Transacting Insurance and Reinsurance Business in Saudi Arabia" *available at* http://www.sama.gov.sa.

Islamic finance related concepts. In fact, the recognition of the insurance activities as well as providing an efficient supervisory system for such activities has always been a necessity in Saudi Arabia and especially after joining the WTO. The shift towards Islamic insurance, is believed, has provided a *means* to circumvent the "legal unrests" that have been caused by the *existing de facto duality.*

However, having introduced certain regulations to govern the insurance sector, the LSCIC created a level of uncertainty as to the Saudi financial system. Thus, it is not very clear why the insurance sector has been made as *Shari'a*-compliant while other components of the Saudi financial system are not. To elaborate, insurance companies along with other institutional investors[265] are responsible for most of the trading in financial markets.[266] Insurance companies are the most important type of institutional investors.[267] In establishing a developed financial system, insurance companies should be able to invest in the financial market. By having an Islamic insurance sector working in accordance with Islamic *Shari'a* principles alongside a conventional finance component, the Islamic insurance sector might have difficulty in investing in the capital market. However, despite the fact that insurance companies will be conducting their business in accordance with the Islamic *Shari'a*; the LSCIC does not refer the insurance disputes to the Islamic *Shari'a* courts. Instead, the LSCIC established the new Insurance Committee which will have the power to hear insurance disputes.

4.3.4 FINAL OBSERVATIONS

The committees that have been established in Saudi Arabia to deal with commercial and financial related disputes are the result of the *existing de facto*

[265] Such as pension funds and investment funds.
[266] MARC LEVINSON, GUIDE TO FINANCIAL MARKETS, at 8 (Profile Books Ltd, 1999).
[267] *Id.* at 9.

duality. It is argued, however, that there is confusion among the litigants regarding the efficiency of these committees and that the decisions issued by these committees have no obligatory nature.[268] According to Muhammad, this is why the litigants have preferred to take their cases to the Islamic *Shari'a* courts.[269] Hence, some commentators have reached the conclusion that these committees are '*quasi-*judicial' and not true judicial bodies.[270]

However, Muhammad agrees that that there is a logical reason behind the existence of these committees, if only because the Islamic *Shari'a* courts are not prepared to apply the "positive laws"[271] such as the Capital Market Law *etc.* Nevertheless, he believes that the *status quo* regarding the judicial system, which is resulting from the *existing de facto duality*, is unsatisfactory and should be resolved. He offers a straightforward solution to the current *status quo* of the judicial system. He argues that there should be one court system, namely, the Islamic *Shari'a* courts.[272] However, within this court system there should be specialised judges who will be specialised in different areas of law such as banking, insurance *etc.*[273] In his view, the appointment of specialised judges will solve the dilemma of having many specialised committees. The reason for reaching such solution is that it is more in line with the Saudi society's mentality.[274]

It is hard to see how this solution can provide an efficient judicial system. Practically speaking, how a judge at the Islamic *Shari'a* court can, even if he is specialised in banking for instance, accept the idea of enforcing interest-bearing

268 Al-Sheikh, *supra* note 170, at 251.
269 *Id.*
270 *Id.*
271 *Id.* at 235.
272 *Id.* at 255.
273 *Id.*
274 *Id.*

transactions, bonds *etc*. The core of the dilemma is not the speciality nature of the courts but it is really the existence of two conflicting body of laws. On the one hand, we have the Islamic *Shari'a* and on the other we have other "positive laws". To unify the judicial system and to have one Islamic *Shari'a* court system means to unify the legislation which is the main reason for the duality in the Saudi judicial system.

Vogel agrees with Muhammad in regards to the *status quo* of the Saudi legal system. He argues that there seems to be an agreement on three main points in this regards. He states[275] "first, the *status quo* is unsatisfactory and unstable; second, the legal system should move toward greater internal harmony, so that increasingly the *siyasa* and *fiqh* laws and courts interact more smoothly and effectively (for example, by elimination of the *siyasa* tribunals and unification of the judiciary); and third, the ultimate system should not be the sort of ideologically dual (secular/religious) legal system...".[276]

While this author agrees with Vogel that the current status quo is unsatisfactory and unstable; it is hard to see how the internal harmony can be achieved? Can the unification between the CRSD and CBSD, for example, on the one hand, and Islamic Shari'a courts on the other be achieved? Can such harmony be achieved in line with the general global trends discussed in Chapter One (i.e., market-oriented policies)? The issues arising from these questions are considered further in the next Section where the author aims to place the cornerstone for his proposition that will be further elaborated and discussed throughout this volume.

[275] VOGEL, *supra* note 143, at 309.
[276] *Id.* In the above statement, the *siyasa* laws and tribunals which are referred to by Vogel are those Committees discussed above, *see supra* Section 4.3.2.

5. THE SAUDI DUALITY AT CROSSROADS

In solving any terminal dilemma, the cause must be identified, surrounded and attacked. The dilemma is the *de facto* "legal unrests" surrounding the Saudi financial system. Thus, Saudi Arabia is incurring extra development costs to compensate outsiders for the uncertainties of its legal system.[277] The cause of the dilemma is the *existing de facto duality* which has resulted from the interaction between Islamic *Shari'a* and modern finance. The symptoms are the appearance of the above-mentioned committees. However, the establishment of these committees is not solving the dilemma because it deals with form rather than substance. These committees provide a form of superficial reform at the surface without actually going to the roots of the dilemma.

Having identified the cause being the *existing de facto duality*, it is desirable to examine what could be the cure. To achieve this, the question is whether this existing de facto duality should be maintained, abolished or modified. To answer such question, for the purposes of this thesis, the *existing de facto duality* should be measured against its implications on the Saudi financial system and related financial transactions. Thus, does the *status quo* achieve the Saudi objective in establishing a market-led financial system? How can conventional financial transactions be transacted effectively in Saudi Arabia?

Indications from surrounding Islamic countries and considering other international developments, as will be discussed in Chapter Five, reveal that certain Islamic countries are taking different approaches to enhance their financial systems and to improve their capabilities in accommodating various financial transactions in

[277] Frank Vogel, *Prospects for a Restatement: The Codification of Commercial and Contract Law in Saudi Arabia, in* COMMERCIAL LAW IN THE MIDDLE EAST, at 31[hereinafter Vogel, *Prospects for a Restatement*] (H. Lewis et al. eds., Kluwer Law International, 1995).

order to meet their developmental needs. The first approach is developing "Islamic finance" alongside conventional finance. Many structures are being structured in an Islamic compliant manner. The development of "Islamic finance", as argued in Chapter One, is simply a reaction to the "legal unrests" that have resulted from transacting conventional financial transactions. Introducing "Islamic finance" in certain Islamic jurisdictions is, therefore, a *means* to avoid the cumbersome burden in attempting to accommodate the conventional financial practice within the Islamic *Shari'a*. Certain Islamic countries are following this approach.

The second approach which is completely a new innovation in the G.C.C Region and which has been applied at a smaller scale to develop a rule-based and a robust international financial centre in order to gain the confidence of international investors is through introducing the "segregation" phenomenon. A whole "free zone" area is established with its own laws, regulations and judicial system. This "free zone" is completely *segregated* from the overall legal system of the country. So there is no interaction between the laws of this "free zone" area and other laws that exist under the relevant jurisdiction. An example of this model is the Dubai International Financial Centre (DIFC). Such model has been introduced in the United Arab Emirates to ensure foreign investors' confidence in the legal framework of the DIFC.

Reverting to Saudi Arabia, its current model appears to be the *existing de facto duality* which generates "legal unrests" because of the interaction between Islamic *Shari'a* and modern finance. This form of duality fits under the 'conflicting' state legal pluralism umbrella which we discussed in Chapter One. This is because there is a conventional financial system and practices *within* an Islamic *Shari'a* system (*i.e.,* a system *within* a system). Conflicts arise between both systems' rules and practices affecting the predictability and certainty of the overall financial legal system. This in turn affect the 'rule of law' required for a well-functioning market-led financial system.

This interaction will be further elaborated and highlighted through studying securitisations and secured transactions in the light of the *existing de facto duality* in Chapters Three and Four. However, rather than going through the thorny route in attempting to combine the inconsistent concepts of Islamic *Shari'a* and modern finance, Saudi Arabia could be enticed to apply a combination of the two approaches mentioned above to achieve its aim in establishing a rule-based market-led financial system.

In considering this "combination" approach, Saudi Arabia would modify its *existing de facto duality* into a much more efficient type of duality that takes into consideration regional and international developments and would enable Saudi Arabia to tap its financial market regionally and internationally. In doing so, Saudi Arabia would develop the "Islamic finance" component of the Saudi financial system and at the same time implements some form of "segregation" to eliminate any potential conflicts between the modern finance practice and Islamic *Shari'a*. This "combination" model will be further explained in Chapter Five.

At this stage, it is enticing to envisage how Saudi Arabia would perceive this "combination" model. Of developing the "Islamic finance" component, there has been a growing academic consensus that Saudi Arabia is not really in favour of "Islamic finance". In fact, Saudi Arabia has been referred to as a country which is "actively discourage a separate Islamic banking presence".[278] The Saudi position has been heavily criticised by the editorial of the Islamic Banker stating:

[278] VOGEL ET AL., *supra* note 143 , at 11. *See also* Ramin Maysami et. al., *One Country, Two Systems: Banking in Malaysia*, 13(7) JIBL 233, at 236-237, (1998) (" ...Saudi Arabia has always been looked at somewhat sceptically as rather pro-Western, and any official recognition given to an Islamic bank

"...Saudi Arabia urgently needs clarity in terms of its position regarding Islamic banking. [It has] to take the political decision either to steer the Kingdom either towards a dual banking system, or towards a fully-fledged Islamic system. The piecemeal approach of the *status quo* is an absurdity which is no longer sustainable, especially as we go into the 21st Century. If Saudi Arabia wants to be taken seriously as an ethical faith-based financial centre, then its rulers must act decisively, and adopt a dual banking system in which an Islamic banking system complete with its own enabling law exists side-by-side with a conventional one, co-operating but not interacting.

Such dual banking models, pioneered by Malaysia, are the mainstay of an increasing number of Muslim countries, including the Gulf States of Bahrain, Kuwait, Qatar and the UAE".[279]

While this has been the case at some point; the attitude towards "Islamic finance" has been changing in recent years. The position is completely different. Islamic Financial Institutions have emerged, neighbouring countries of the G.C.C have introduced "Islamic finance" related laws and other successful models have emerged such as in Malaysia. In addition, The U.A.E established the DIFC and Qatar is following a similar route by establishing the Qatar Financial Centre.[280] These Centres do have "Islamic finance" related laws.

would label conventional banks "un-Islamic" by comparison. It is thus believed that the Government was wary of according special status to Islamic banks by granting these institutions the necessary licences to operate: once the first distinction between "Islamic" and "un-Islamic" is made, it will be difficult to resist pressure from fundamentalists groups to "Islamise" the entire Islamic system. This they do not wish to do..."). *See also*, Wilson, *supra* note 3, 60 -61 (RoutledgeCurzon, 2004).

279 Editorial, *A Very Saudi Corporate Identity Crisis*, 101 ISLAMIC BANKER 2, at 2, (2004).

280 *See generally* http://www.qfc.com.qa/

All these developments that will be explored further in Chapter Four add up and exercise some form of pressure on Saudi Arabia. For example, under the G.C.C agreements; Saudi Arabia is required to unify its existing financial and banking legislations with the neighbouring countries of the G.C.C. In this sense, Saudi Arabia would consider "Islamic finance" more seriously. However, external pressures are not the only reasons for considering "Islamic finance". As mentioned earlier, Saudi Arabia has expressed its willingness in the Eighth Development Plan to develop an Islamic mortgage system.[281] Also, Saudi Arabia has introduced the "Islamic insurance" being the only *means* to provide insurance services in the Kingdom. This is an indication that Saudi Arabia is accepting "Islamic finance" at the policy level. So, it is the author's believe that Saudi Arabia would welcome developing the "Islamic finance" component of its financial system as a part of the "combination model".

Turning to the second part of the "combination model", that is; introducing the "segregation" phenomenon. How would Saudi Arabia perceive *segregating* its modern finance practice from the overall legal system? Perhaps such process could be much harder than developing the "Islamic finance" component of the Saudi financial system due to the political issues that could arise. However, it can be argued that Saudi Arabia has been experiencing some form of *segregation* already.

Thus, consider the establishment of the committees that the author has discussed earlier. While these committees are the result of the *existing de facto duality*, their establishment reflect an attempt to *segregate* their functions from the overall legal system of the Islamic *Shari'a*. By proposing the full "segregation" phenomenon adopted in the DIFC as part of the "combination model", the author is not proposing

[281] *Eight Development Plan*, *supra* note 62, at 320.

an entirely new approach. Instead it is a call to finalise the "unfinished agenda". This, however, goes hand in hand with developing the "Islamic finance" component. It is, therefore, fair to conclude that such approach could be welcomed.

In the light of the above discussion, this volume suggests that the *existing de facto duality* should neither be maintained nor abolished but instead it should be modified. To this effect, Saudi Arabia is advised to replace the *existing de facto duality* by adopting the *new modified duality*. This can be done by further *dualising* the Saudi financial system whereby a conventional financial system is not functioning *within* an Islamic *Shari'a* system but *alongside* an Islamic financial system (*i.e.*, a system *alongside* a system). This conventional finance component is *segregated* from the overall legal system of Islamic *Shari'a*.

The main aim for such reform should be the development of a *parallel dual rule-based financial system* which meets the requirements of a market-based economy and maintains at the same time the 'rule of law'. This *new modified duality* fits under the 'non-conflicting' state legal pluralism umbrella discussed in Chapter One. Unlike the *existing de facto duality*; the *new modified duality* involves *segregating* the conventional finance component from the overall Islamic *Shari'a* realm; and at the same time, building an Islamic financial system alongside its conventional counterpart. This, it is hoped, would serve creating a robust and efficient dual financial system which meets the requirements of a market-based economy.[282]

[282] *See* Zaki Badawi, *Which Banking System –Dual or Single?*, 34 ISLAMIC BANKER 16, at 17, (1998) (Badawi states: "Is it permissible and feasible for a Muslim state to have two systems: Islamic and conventional? the feasibility is demonstrated by Malaysia, Egypt, Jordan and some other countries where Islamic banking is allowed to function..". He argues that Islamic banking should serve Muslims and the conventional banking should serve non-Muslims. However , he adds: " ...in all circumstances, there is no objection to maintaining the two systems [Islamic and conventional banking] in parallel during a transition stage- as long as the ultimate intention is to lead financial and commercial sector to the Islamic business and financial system.") . This Chapter, however, does not discuss from a religious viewpoint whether adopting a dual financial system is Islamic or not. The proposition made for Saudi Arabia; is taking into consideration that the conventional financial system is already existing and

6. CONCLUSION

This Chapter reveals that Saudi Arabia is desirous to adopt market-based policies and to establish a market-led financial system. To this effect, Saudi Arabia has passed several major laws that aimed at facilitating the functions of the Saudi financial system. These laws, however, have caused the *existing de facto duality* and a duality within the Saudi judicial system. In addition, the interaction between the Islamic *Shari'a* and modern finance has generated "legal unrests" that could undermine the effectiveness of the Saudi financial system and in turn adversely affecting the proper implementation of Saudi market-based policies.

The Chapter also argued that two approaches have developed by other Islamic countries in order to eliminate any potential conflicts between modern economy and Islamic *Shari'a*. These are the development of "Islamic finance" and the emerging phenomenon of "segregation" that has been implemented in the DIFC. The Chapter proposes that a combination of both approaches would serve a good model for the Saudi financial sector law reform process. To this effect, Saudi Arabia is advised to modify its *exiting de facto duality* into a *new modified duality* whereby a conventional financial system is functioning alongside an Islamic financial system and at the same time the conventional finance component should be *segregated* from the overall legal system of Saudi Arabia. This model will be further examined in Chapter Five. In the following two Chapters, however, the author takes a closer look

recognised. Also, adopting a dual financial system may offer a strategy prior to Islamising the whole financial sector. Arguably, it is not viable to transfer the conventional financial system into an Islamic one rapidly. *See* MUHAMMAD CHAPRA, TOWARDS A JUST MONETARY SYSTEM, at 227 (The Islamic Foundation, 1985): " It would...be a mistake to try to achieve the transition from the conventional capitalist money and banking system now prevalent in the Muslim world to the just Islamic model in one stroke or over a very short period of time. Such an attempt could suffocate the whole system and do great damage to the economy ...". However, it is evident that Islamic finance flourishes in free market economies rather than in states where government control the banking sector; hence, economic liberalisation aids Islamic finance rather than hindering its development. *See generally* Rodney Wilson, *The Politics of Islamic finance*, 147 NEW HORIZON 5, (2005).

as to the impact of the *existing de facto duality* on financial related transactions to further enrich the reader's understanding of the author's theme.

CHAPTER THREE

THE DUALITY OF SAUDI LEGAL SYSTEM AND ITS IMPLICATIONS ON SECURITISATION TRANSACTIONS*

CHAPTER OUTLINE

* In connection with the author's doctoral research, this Chapter has been published in two journals with the doctoral supervisor's permission. *See* Amr Marar, *Saudi Arabia: The Duality of the Saudi Legal System and Its Implications on Securitisations,* 27 COMPANY LAWYER 344, (2006). Reprinted in 20 Arab Law Quarterly 389, (2006).

1. INTRODUCTION

In the previous two chapters, the author attempted to explain the broader view surrounding the theme of this volume. Chapter One introduced market economy policies, their interaction with the Islamic *Shari'a* and the development of "Islamic finance" highlighting the current trend in the Islamic countries. Then, Chapter Two moves closely to the case of Saudi Arabia examining this broader view of the interaction and its implications as to the Saudi financial system. This Chapter goes further and moves closer to study a specific financial transaction (*i.e.,* securitisation) in the light of the Saudi legal system to establish the author's theme. This being that the Saudi financial system is constrained by the *existing de facto duality* and despite the various laws that Saudi Arabia has introduced; an *interaction* between the Islamic *Shari'a* and modern finance still exists. This would have potential adverse implications on these transactions.

For elaboration purposes, therefore, this Chapter considers how a modern financial innovation – asset securitisation - might interface within the Islamic law-based Saudi system. Generally, asset securitisation is a financial technique that links the capital markets with the banking markets[1] by allowing banks to convert their "receivables and other assets that are not readily marketable into securities that can

[1] JOSEPH NORTON, FINANCIAL SECTOR LAW REFORM IN EMERGING ECONOMIES, at 236 (BIICL, 2000).

be placed and traded in the capital markets".[2] It is a relatively recent financial innovation which has been developed in the United States.[3]

However, this financial technique has been exported outside the US to other countries and has been applied successfully in the United Kingdom as well as in other parts of Europe.[4] Many benefits, which are explained below, have been brought by using asset securitisation. For example, in using asset securitisation, banks would be able to adjust their balance sheet and improve liquidity,[5] borrowers would be able seek lower cost of fund by accessing the capital market,[6] and investors would be able to invest in highly rated securities with great yields.[7]

Given its benefits, it is believed by many government policymakers and by the International Financial Institutions that securitisation techniques contribute to the overall economic growth in the country, including developing, transitioning and emerging economies.[8] For example, the positive indications and advantages of using securitisation in the developed and industrialised countries[9] have encouraged the

[2] Kenneth Elmgren, *An Overview of Securitisation, in* INTERNATIONAL ASSET SECURITISATION, at 1 (Joseph Norton et al. eds., Lloyd's of London Press Ltd, 1995). Receivables *inter alia* refer to assets like "mortgage and charge debts, car loans, insurance premiums, credit card debts, secured consumer loans, equipment loans, freights (including sub-freights), rentals from real and personal property, debts for goods sold or services rendered". *See* FIDELIS ODITAH, LEGAL ASPECTS OF RECEIVABLES FINANCING, at 2 (Sweet & Maxwell, 1991).
[3] *See generally* Elmgren, *supra* note 2.
[4] *See generally* ASSET-BAKED SECURITISATION IN EUROPE (Theodor Baums et al. eds., Kluwer Law International, 1996).
[5] Bharat Jain, *Promoting Securitisation in Emerging Economies, in* ACCESSING CAPITAL MARKETS THROUGH SECURITISATION, 205, at 210 [hereinafter ACCESSING CAPITAL] (Frank Fabozzi eds., Frank J Fabozzi Associates, 2001).
[6] Joseph Shenker et al., *Asset Securitisation: Evolution, Current Issues and New Frontiers*, 69 TEX. L. REV 1369, at 1371, (1991).
[7] *Id.* at 1371-1372.
[8] *See generally* Leonora Walters et al., *A Helping Hand*, 73 INT'L SECURITISATION REP. 15, (2002-2003). *See also* Lee Meddin, *Structured Finance in the Emerging Markets, in* GLOBAL SECURITISATION REVIEW (2004-2005), 1 (IFC & Euromoney). *See also* Lakshman Alles, *Asset Securitisation and Structured Financing: Future Prospects and Challenges for Emerging Market Countries*, (IMF Working Paper, 2001).
[9] For example, in 2001 asset-backed and mortgage-backed securities accounted for 28.3% of the US$ 17.7tr US bond market. *See* Murra, *Id.* at 15.

International Finance Corporation (IFC)[10] affiliate of the World Bank Group to take an active role in promoting securitisation to developing countries and emerging markets.[11]

Nevertheless, the growth of the securitisation markets outside the developed countries arena has been slow.[12] The slow adoption of securitisation outside the developed countries can be attributed to different reasons including: the lack of experience in secured transactions,[13] the absence of desirable pools of receivables,[14] the extent of the involvement of the central bank as well as the commercial banks in promoting securitisation,[15] unavailability of a strong institutional infrastructure and investor base[16] and the restrictive regulator environment.[17]

Hence, securitisation cannot be applied successfully in emerging markets unless structural problems with the banking sector as well as equity and debt markets are addressed.[18] In addition, developing a suitable legal framework to accommodate the 'legally-intense' technique of securitisation is at the heart of the financial legal reforms that need to be addressed by the developing countries that are aiming to improve capital investment securities and mortgage markets. Therefore, it is suggested that a legal framework that supports the functioning of the financial system should include a basic asset securitisation law.[19] Numerous developing countries (*e.g.*, People's Republic of China, Argentina, Mexico, Thailand and South Africa) have adopted asset securitisation legislations.

[10] *See generally* http://www.ifc.org
[11] The IFC role involves advising and assisting emerging markets on their first products. Also, the IFC participates in structuring and providing credit enhancement to securitisation deals.
[12] NORTON, *supra* note 1, at 237.
[13] *Id.*
[14] *Id.*
[15] Jain, *supra* note 5, at 208.
[16] *Id.* at 207
[17] NORTON, *supra* note 1, at 237.
[18] Jain, *supra* note 5, at 212.
[19] NORTON, *supra* note 1, at 50.

In the light of this, the Kingdom of Saudi Arabia can benefit from a financial technique such as securitisation. In fact, various attempts in using securitisation techniques in the Kingdom began as early as 1993.[20] However, as argued in this Chapter, the Saudi legal infrastructure is not wholly supportive of securitisation transactions. The *existing de facto duality* has its impact, *inter alia,* on one of the major steps in securitisations, namely, the sale of assets. This Chapter analyses these issues being an example of the current dilemma of the Saudi financial system that has resulted from the interaction between Islamic *Shari'a* and modern finance techniques which is the theme of this volume.

This Chapter also shows an example of an "Islamic finance" product that has emerged as a result of the interaction between Islamic *Shari'a* and global economy. This "Islamic finance" product is referred to as "Islamic securitisation" and is developed to offer benefits that are similar to those offered by conventional securitisations while complying at the same time with the Islamic *Shari'a*.[21] The development of "Islamic securitisation" goes beyond the fact that it is a reaction to the "legal unrests" caused by the interaction between Islamic *Shari'a* and modern finance. Thus, "Islamic finance", including "Islamic securitisations", is relevant to the securitisation industry. It is suggested that: 1) Islamic investors are an attractive pool of investors that can be tapped for placement of capital market instruments issued by securitisation vehicles;[22] and 2) there are many originators (particularly in

[20] THE ECONOMIST INTELLIGENCE UNIT LIMITED, COUNTRY FINANCE: SAUDI ARABIA (2004) at 16 (the report states that securitisation of receivables has begun in the automobile cars to improve the liquidity of the cars dealers. No further details have been provided in this report regarding the techniques used).

[21] *See* the discussion *infra* (in relation to the principles of Islamic *Shari'a* that contravene with conventional securitisations).

[22] Abradat Kamalpour et al., *Islamic Securitisation, in* GLOBAL SECURITISATION AND STRUCTURED FINANCE, 220, at 220, (Globe White Page Ltd., 2006) [hereinafter GLOBAL SECURITISATION] . *See also* Michael McMillen et al., *An Innovation in Financing – Islamic CMBS, in* COMMERCIAL MORTGAGE-BACKED SECURITISATION, 382, at 402 (Andrew Petersen ed., Sweet & Maxwell, 2006)

the Middle East and Far East) that wish to securitise their pool of financings in an Islamic compliant fashion.[23]

Recently, this "Islamic securitisation" technique has been used to securitise the receivables of a leading car rental company in Saudi Arabia.[24] Such initiatives show that there is marked interest by the Saudi private sector financial community in seeking alternative methods to raise funds. Whether the Saudi legal system is developed enough, even after the new introduced legal reforms, to accommodate these initiatives and to meet the private sectors' interests in securitisation is questionable.

It can be argued that the use of "Islamic securitisation" in Saudi Arabia rather than conventional securitisation is attributed to the fact that the general paramount legal system is Islamic *Shari'a*. Thus, there is a legal dimension in using an "Islamic securitisation" structure, that is, the belief that such structure works more efficiently within the Saudi legal system. Nevertheless, there are no laws or regulations that specifically govern "Islamic securitisation". For instance, none of the provisions of the Saudi Capital Market Law[25] address the issue of *sukuk*[26] (*i.e.*, Islamic bonds).[27]

As indicated in Chapter Two, there are indications that Saudi Arabia is interested to develop the Islamic finance industry.[28] This should be accompanied, however,

(arguing that Commercial-Mortgage-backed Securitisation *sukuk* could easily emanate from the US and Europe as opposed to Islamic countries because there is an increased involvement in Islamic finance by international banks, those banks have substantial *Shari'a* compliant assets, they have significant securitisation experience and international banks can obtain the necessary ratings as the transaction will be structured within a jurisdiction with a supportive legal framework).

[23] *Id.*

[24] Lousie Bowman, *Saudi's True-Sale Vehicle*, 87 INT'L SECURITISATION REP. 24, 2004.

[25] Capital Market Law, Royal Decree Number M/3, July 2003 *available at* http://www.cma.org.sa.

[26] However, Saudi Capital Market Authority has authorised the issuance of *sukuk* in Saudi Arabia. *See* OFFERING CIRCULAR, SABIC BASIC INDUSTRIES CORPORATION, 3 July 2006 [hereinafter OFFERING CIRCULAR] *available at* http://www.cma.org.sa

[27] *See generally* NATHIF ADAM ET AL., ISLAMIC BONDS: YOUR GUIDE TO ISSUING, STRUCTURING AND INVESTING IN *SUKUK*, (Euromoney, 2004) (discussing Islamic bonds in detail).

[28] *See, e.g., The Eighth Development Plan*, at 320 *available at* http://www.planning.gov.sa/. (referring to the desire to establish an Islamic mortgage system).

with a supportive legal framework that could include "Islamic securitisation". As will be seen later, not all the assets can be securitised using "Islamic securitisation". Since Saudi Arabia does maintain a conventional financial practice, Saudi Arabia might consider the advisability of developing both securitisation markets (*i.e.*, Islamic and conventional); in line with the current trend discussed previously. That is, adopting both Islamic and conventional financial practice.

2. SECURITISATION: GENERAL OVERVIEW

2.1 ELEMENTS OF SECURITISATION

Securitisation is not only a process which involves the issuance of securities: other financial techniques might involve such a role (*e.g.*, traditional debt securities offering in the capital market).[29] However, in this Chapter, securitisation is referred to as "a form of financing where monetary assets with predictable cash flows are pooled and sold to a specially created third party that has borrowed money to finance the purchase. These borrowed funds are raised through the sale of asset-backed securities, which can take the form of either commercial paper or bonds".[30] Securitisation is a form of structured finance.[31] Structured finance involves using a specific structure in order to reallocate the risks resulting from such transaction. Thus, in securitisation, the monetary assets to be securitised are structurally isolated from the former owner of the assets.[32] Hence, the risks that associated with

[29] Shenker, *supra* note 6, at 1373-1374 (arguing that there is not satisfactory uniform definition for securitisation and that the term is normally used to mean different things. Also, he argues that definitions that define securitisation to involve the issuance of securities only fail to mention the characteristics of asset securitisation which distinguish it from other financial techniques).
[30] W. Alexander Rover et al., *A Primer on Securitisation*, 9(2) J. STRUCTURED & PROJECT FIN. 5, at 5, (2003).
[31] *Id.*
[32] THE COMMITTEE ON BANKRUPTCY AND CORPORATE REORGANISATION, ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK, *Structured Finance Techniques*, Bus. Law. 527, at 528. 1995.

securitisation are mainly tied to the repayment of the monetary assets rather than to the performance of a specific project or entity.[33]

Generally, any securitisation transaction involves five main elements.[34] The first element is the existence of a pool of receivable *monetary assets*. Such assets should be identified by the *originator* (*i.e.,* the entity that owns the assets and aims to securitise them).[35] Thus, the originator begins by forming a pool of homogenous assets.[36] These assets could be mortgage loans, credit card receivables, auto loans, *etc*. Nowadays, the list of the assets that could be securitised is growing to include a variety of other assets such as leases, pharmaceutical patent revenues, trademark leases, insurance related transactions, *etc.*[37] The eligibility of a specific group of assets for securitisation and their capability for commoditisation depends on the sufficient stability and predictability of these assets.[38] The ability to predict the performance of the underlying pool of assets is a key to the success of the securitisation transaction.[39]

The second element, which has been described as the linchpin of the securitisation process,[40] is the establishment of a *Special Purpose Vehicle* (SPV). The SPV is the legal entity used to segregate the assets being securitised from certain risks associated with the originator. Thus, after the assets have been identified by the originator; the originator transfers the assets to the newly established SPV. Such

[33] Rover et al., *supra* note 30, at 5.
[34] Daniel Singer, *Securitisation Basics*, in ACCESSING CAPITAL, *supra* note 5, at 13, 15.
[35] NORTON, *supra* note 1, at 238.
[36] *See* BASEL COMMITTEE REPORT ON ASSET TRANSFERS AND SECURITISATION (Sept. 1992), at 2 (emphasising on the necessity of homogeneity for two reasons: to enable cost efficient analysis and to achieve common payment pattern), [hereinafter BASEL REPORT] *available at* http://www.bis.org/
[37] Ellen Welsher et al., *Securitisations of "New Asset" Classes: A Rating Approach*, 10(2) J. STRUCTURED FIN. 20, 20, (2004). *See, e.g.,* on insurance-related securitisation H. Wang, *Securitisation of Insurance Risk: Devising an Appropriate Regulatory Framework, in* YEARBOOK OF INTERNATIONAL FINANCIAL AND ECONOMIC LAW (2000-2001) (Joseph Norton et al. eds., BIICL, 2003).
[38] Welsher et al., *supra* note 37, at 20.
[39] Singer, *supra* note 34, at 13.
[40] *Id.* at 15.

transfer of assets should be structured in a way to constitute a "true sale".[41] This means that the receivables have been completely removed from the originator's ownership in case of bankruptcy.[42] In this sense, the SPV has to be structured as "bankruptcy remote", so it is not affected by the bankruptcy of the originator.[43]

There are five characteristics that should be adopted in order to establish a bankruptcy remote SPV:[44] 1) restriction on objects and powers;[45] 2) debt limitations;[46] 3) independent director(s);[47] 4) no merger or reorganisation[48] and 5) separateness.[49] The establishment of the SPV in a securitisation transaction is what distinguishes securitisation from other capital raising techniques such as issuing debt or equity securities. Unlike issuing commercial investment securities, through securitisation the originator achieves non-recourse financing[50] because investors will be mainly looking to the cash flow generated by the assets for repayment rather than to the originator's assets or creditworthiness.[51] The establishment of the SPV is intended to achieve this non-recourse feature of securitisation.

The third element in any securitisation transaction is to seek *credit enhancement* in order *to minimise the associated risks*, for example, the risk of delayed payments

---

[41] Steven Schwarcz, *The Alchemy of Asset Securitisation*, 1(1) STAN. J. L. BUS & FIN 133, 135 (1994).
[42] *Id.* However, some limited recourse may be permitted as in the case of fraud or intentionally false representations and warranties.
[43] Schwarcz, *supra* note 41, at 135.
[44] James Penrose, *Special-Purpose Entities in Project Finance Transactions*, 2(3) J. STRUCTURED & PROJECT FIN. 58, 60, (1996) (explaining the SPV's characteristics in the context of project finance, which equally apply in the context of securitisation).
[45] In the articles of the incorporation the objects clause restricts the powers of the corporation to the activities of the transactions only. However, in the securitisation transactions the SPV might take the form of trust.
[46] Any additional debts to finance the purchase of the assets from the originator should be restricted.
[47] The SPV which is controlled by the originator is usually requires to have an independent director.
[48] *See* Penrose, *supra* note 44, at 62.
[49] Separateness means that the SPV should be clear to the whole world that it is an independent entity and especially from any involvement of a parent company. *See* Penrose, *supra* note 44, at 62.
[50] Edward Park, *Allowing Japanese Banks to Engage in Securitisation: Potential Benefits, Regulatory Obstacles, and Theories for Reform*, 17 U. PA. J. INT'L ECON. L. 723, at 732.
[51] Yoshiki Shimada et al., *Japanese Asset Securitisation: A Guide for Practitioners*, 38 HARV. INT'L L. J. 171, at 171 (1997).

or payment default under the receivables.[52] These defaults will result in payment losses or payment delays to the investors.[53] The amount of "credit enhancement" required is determined on a transaction-specific basis.[54] Additionally, providing credit enhancement for the securitisation transaction will result of better credit agency rated securities.[55] Such credit enhancement can be either external or internal.[56] The purpose of using a credit enhancement mechanism is to increase the certainty for investors that cash flow will be paid as expected. There is variety of *internal* credit enhancement mechanisms,[57] including overcollateralisation,[58] cash collateral accounts,[59] and senior-subordinate structure.[60] However, credit enhancement can be provided *externally* through third-party guarantees or a third-party letter of credit or insurance.[61]

The fourth element is *servicing the securitisation*.[62] In any securitisation structure there needs to be a servicer to monitor the performance of the securitised assets and

---

[52] *Id.* at 173.
[53] Rover et al., *supra* note 30, at 10.
[54] *Id.*
[55] In order for the securities to be marketed to investors, the originator will seek independent credit rating agencies such as Standard & Poor's Ratings Group, Moody's Investor Service, Fitch Investors Services and Duff & Phelps. The aim of these agencies is "to gauge credit quality and make investment decisions. A credit rating is not a recommendation to purchase, sell, or hold a particular security. The rating performs the isolated function of credit risk evaluation, which is only one element of the entire investment decision-making process". *See supra* note 32, at 535. *See also* Paul Taylor, *Credit Ratings on International Asset-Backed Securities, in* INTERNATIONAL ASSET SECURITISATION, *supra* note 2, at 161
[56] Rover et al., *supra* note 32, at 10.
[57] Singer, *supra* note 37, at 18.
[58] Overcollaterlisation is an internal credit enhancement mechanism provided by "issuing bonds with a par value that is less than the par value of the loans or receivables in the collateral pool". *See* Rover et al., *supra* note 32, at 10.
[59] A cash collateral account is "a deposit equal to the necessary credit enhancement which is held for the benefit of the holders of the securities". *See* BASEL REPORT, *supra* note 36, at 4.
[60] In such structure at least two classes are issued where one class of securities is subordinate to the other senior class of securities. The holders of the subordinated securities are subordinated in payments, which mean that they absorb the losses for the benefit of the senior securities. *See* Rover et al., *supra* note 32, at 11. *See also* NORTON, *supra* note 2, at 247. However, subordinated securities will have higher yield.
[61] Rover et al., *supra* note 32, at 10.
[62] Singer, *supra* note 34, at 19.

the cash flow. Servicing is normally undertaken by the originator,[63] which will be responsible for preparing a monthly detailed report that can be distributed to the investors, rating agencies and credit enhancers.[64] The last element of the securitisation process is the *underwriting*.[65] This is basically the purchase of the securities by an investment bank and reselling them to the public as debt instruments in the capital/investment securities markets.[66]

2.2 INCENTIVES FOR SECURITISATION

2.2.1 GENERAL BENEFITS FROM SECURITISATION

The advantages of securitisation are numerous. Borrowers, originators, investors and the financial economy as a whole can benefit from the securitisation technique.[67] For the overall economy, securitisation provides a lower cost capital and a more efficient financial system.[68] It also helps in improving the liquidity of the economy's credit market.[69] Further, securitisation offers new investment instruments for institutional and other investors.[70] It gives the investors the opportunity to diversify their portfolios and increases their choice.[71] Asset-backed securities offer greater protection to investors compared to traditional debt securities.[72]

As for the originator, the advantages are manifold.[73] One of the compelling reasons for the originator to use securitisation is that it provides an alternative and

[63] The originator charges fee for such activity.
[64] Singer, *supra* note 34, at 19.
[65] *Id.* Singer refers to underwriting as "the process of selling securities by an investment bank..." *Id.* However, selling the securities in a securitisation might take different mechanisms each have it characteristics such as placement arrangements or purchase arrangements. On the different mechanics of the distribution of securities *see* ROSS CRANSTON, PRINCIPLES OF BANKING LAW, at 335 (Oxford University Press, 2002).
[66] Singer, *supra* note 34, at 19.
[67] Park, *supra* note 50, at 728. *See also supra* note 8.
[68] Park, *supra* note 50, at 728.
[69] NORTON, *supra* note 1, at 241.
[70] JAMES ROSENTHAL ET AL., SECURITISATION OF CREDIT, at 13 (John Wiley & Sons, Inc., 1988).
[71] *Id.*
[72] *Id.*
[73] Gilles Thieffry et al., *Securitisation: The New Opportunities Offered by Economic and Monetary Union*, 12 J.I.B.L 463, at 464 (1997).

efficient source of funding.[74] The originator can raise capital immediately without the need to wait for the repayment of the receivables.[75] By using securitisation, the originator can achieve lower cost of funds.[76] This is because the originator issues securities through the SPV which is de-linked from the originator's own credit ratings.[77] Hence, securitisation normally achieves a higher credit rating than that of the originator.[78] Securitisation provides an efficient source of liquidity allowing the originator to vary its sources of credit and widen the range of its creditors away from traditional bank financing.[79]

However, using securitisation allows the originator to transfer a range of credit risks to the investors,[80] thus, transforming these risks into one single risk.[81] Also, securitisation allows for better management of the balance sheet.[82] By transferring the assets to an SPV in order to be securitised, both assets and liabilities will be removed from the balance sheet.[83] This leads to an improvement in the financial ratios.[84] The originator can raise money without the loan appearing on its balance sheet.[85] This capital structure improvement is important especially for banks that comply with the Basel Committee on Banking Supervision guidelines[86] on capital adequacy. Thus, through securitisation, a bank can avoid reserving the required

---

[74] NORTON, *supra* note 1, at 240.
[75] PHILIP WOOD, TITLE FINANCE, DERIVATIVES, SECURITISATIONS AND SET-OFF AND NETTING, at 45 (Sweet & Maxwell, 1995).
[76] Rover et al., *supra* note 30, at 7.
[77] *Id.*
[78] NORTON, *supra* note 1, at 240.
[79] Thieffry et al., *supra* note 73, at 464.
[80] NORTON, *supra* note 1, at 241.
[81] *Id.*
[82] Thieffry et al., *supra* note 73, at 464.
[83] NORTON, *supra* note 1, 241.
[84] Thieffry et al., *supra* note 73, at 464.
[85] WOOD, *supra* note 75, at 45
[86] NORTON, *supra* note 1, at 242.

capital to support the receivables being securitised by selling them and removing such liabilities from its balance sheet.[87]

2.2.2 Possible Benefits For An Emerging Economy Such As Saudi Arabia

There is no doubt that an emerging economy such as Saudi Arabia could benefit from a financial technique such as securitisation. Other emerging economies such as Mexico and Argentina have already realised the importance of securitisation and have taken measures in order to create a "securitisation-friendly" market. One of the main aims for creating a "securitisation-friendly" market is to increase the availability of affordable low-cost housing.[88] Hence, certain measures took place (*e.g.*, in Mexico) to facilitate mortgage-backed securitisations.

While each country has its own specific needs, Saudi Arabia would join Mexico in its need for a low-cost housing. There is a huge demand for housing in Saudi Arabia because of the rapidly growing population.[89] Few banks in Saudi Arabia have introduced mortgage products.[90] Hence, it is believed that there are significant opportunities in setting up specialised funds (*e.g.*, mortgage funds) through securitisation.[91] Securitisation would offer a useful, an efficient and a low cost method of financing for the Saudi real estate industry. In addition, the use of securitisation is not confined to the Saudi housing industry but can be used in financing the Saudi construction industry which is the largest non-oil economic sector in Saudi Arabia.

---

[87] WOOD, *supra* note 75, at 46

[88] *See generally* David Banowsky et al., *Secured Financing Issues for International Lenders: Bridging the Gap Between Civil and Common Law through Asset-backed Securitisation – Lessons From and Respecting Argentina and Mexico, in* EMERGING FINANCIAL MARKETS AND SECURED TRANSACTIONS, 307 (Joseph Norton et al. eds., Kluwer Law International, 1998).

[89] THE ECONOMIST INTELLIGENCE UNIT LIMITED, COUNTRY FINANCE: SAUDI ARABIA (2005), at 47.

[90] *Id.*

[91] *Id.*

However, other market players in Saudi Arabia and a number of different sectors could benefit from this financial technique. For example, Saudi banks could benefit from securitisation to avoid capital adequacy requirements imposed by the Saudi Arabian Monetary Agency (SAMA) which imposes higher capital adequacy ratio above the 8% recommended by the Basel Committee on Banking Supervision. According to the Saudi Banking Control Law, the capital adequacy ratio may vary but SAMA normally keeps the ratio around 18%. Such ratio may constrain the commercial banks from using its liquid funds to enter into new business opportunities. Hence, securitisation offers a method whereby Saudi banks can remove the exiting receivables from their balance sheet. Also, as Saudi Arabia is going through a process of privatisation, the private sector is therefore in need of capital to fund this process. Securitisation offers an alternative means of financing that would facilitate the privatisation process through making the fund available at a lower cost and long term basis.

2.3 RISKS OF SECURITISATION

There are certain risks that are associated with securitisation transactions. In order to achieve a successful transaction, these risks need to be managed and minimised. For example, in order for asset-backed securities to be widely marketable, investors' exposures need to be minimised to an acceptable level.[92] One of the most serious risks in a securitisation transaction is the failure to duly transfer the assets from the originator to the SPV (*i.e.*, the issuer).[93] As mentioned earlier, such transfer should amount to a 'true sale'.[94] In case such 'true sale' is not achieved, the assets may not be deemed removed completely from the originator's ownership

[92] CRANSTON, *supra* note 65, at 372.
[93] NORTON, *supra* note 1, at 242-243. *See also* BASEL REPORT, *supra* note 36, at 6.
[94] *See* the discussion *infra*.

and its financial balance sheet. Therefore, the originator might remain subject to claims regarding the securitised assets in case of their non-performance[95] and therefore subject to risk.

However, even after the transfer of the assets on a 'true sale' basis, there are other risks associated with the securitisation transaction. Firstly, after the transfer of the assets to the issuer (*i.e.,* SPV), the credit risks attached to the underlying assets will be transferred accordingly.[96] "Credit risk" means the risk that the receivables are not collectible.[97] The credit risk is related to the quality of the securitised assets.[98] The quality of the securitised assets are, in turn, based on whether the obligors meet their obligations and whether, in case of default and enforcement, the proceeds of the sale of the securitised assets are sufficient for the full payment of principal and interest.[99] However, credit risks can be minimised by the availability of *credit enhancement* mechanisms mentioned earlier.[100]

Secondly, another risk that could undermine the securitisation transaction is the "liquidity risk". Liquidity risks refer to the risk of shortfall of cash flow to meet the issuer's payments obligations towards the investors.[101] The reason is the timing mismatch between collecting the receivables and the repayment to investors.[102] This timing mismatch may be caused by the debtors' delay in payment or because of the

[95] NORTON, *supra* note 1, at 243.
[96] CRANSTON, *supra* note 65, at 372.
[97] WOOD, *supra* note 75, at 57.
[98] COLIN PAUL ET AL., BANKING AND CAPITAL MARKETS COMPANION, at 281 (Cavendish Publishing Limited, 2003).
[99] *Id.*
[100] *E.g.*, credit risks can be minimised by using the overcollateralisation, *see* WOOD, *supra* note 75, 57. *See also supra* note 58.
[101] PAUL ET AL., *supra* note 98, at 281.
[102] WOOD, *supra* note 75, 57.

receivables term.[103] Also, it could be caused by the performance risk of the servicer.[104]

A third risk which is associated with the securitisation transaction is the "interest basis risk", which is the risk of a mismatch between the interest rates on the receivables and the interest rates to be paid to the investors.[105] Finally, there can be a "reinvestment risk", which is the risk that might result from the recovery of high interest-bearing receivables by the SPV before the due date of the securities and the inability of investing this sum with the same profitability.[106]

3. LEGAL ASPECTS OF SECURITISATION

Generally, as mentioned earlier, a securitisation structure involves a transfer of the originator's assets.[107] Such transfer has to achieve what is referred to as 'true sale'. The use of the term 'sale' is a banking jargon.[108] Hence, referring to the originator as the seller of the assets is not an accurate legal description.[109] Normally, the assets which are sold in securitisation transactions are loans (*i.e.*, principal and interest). Such assets can not be sold like other tangible assets or goods. For example, under English law; the Sale of Goods Act 1979 excludes money from its definition of goods.[110] However, different legal mechanisms might provide the legal *means*

[103] *Id.*
[104] Rover et al., *supra* note 30, at 13(arguing that investors in the securitisation transaction are exposed to the performance risk of the servicer. Thus, if the servicer does not perform adequately, payment delays may occur. Hence, it is advised that there should be a back-up servicer). However, there is normally a liquidity facility agreement whereby the liquidity provider commits to provide liquidity when needed.
[105] WOOD, *supra* note 75, 57.
[106] *Id.*
[107] Such is a matter of domestic law and applicable accounting rules.
[108] CRANSTON, *supra* note 65, at 360.
[109] *Id.*
[110] *See, e.g.,* Section 61 of the Sale of Goods Act 1979 which defines goods to include "all personal chattels other than *things in action and money,* and in Scotland all corporeal moveables except money; and in particular "good" includes emblements, industrial growing crops, and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale and includes an undivided share in goods".

through which the originator's assets can be sold under English law; these would be assignment, novation and sub-participation. Prior to discussing these legal mechanisms; a brief description of the legal nature of the assets being sold in a securitisation transaction is necessary.[111]

3.1 THE LEGAL NATURE OF THE SECURITISED ASSETS

The tradability of debt assets is considered as one of the most discoveries that have deeply affected the fortunes of human race.[112] In commercial and banking practices, companies and banks do sell their assets- that is, loans, credit card receivables and so on. Many modern transactions are based on the idea of selling debts, including securitisation and factoring.[113] For lawyers, however, there must be a clear legal understanding and analysis of what exactly is being sold. Such understanding is crucial to execute these transactions effectively and successfully. Hence, a brief overview of what is being sold in a securitisation transaction is necessary.[114]

As receivables are financial assets that cannot be "sold" in the legal sense, they are transferred (in the English context) through assignment or novation. Such transfer or sale of the securitised assets involves the transfer of the *rights* to the receivables. Legally speaking, what are being transferred are not the actual receivables but the *rights* attached to them. One traditional English law classification of *rights* is, 1) real

---

[111] Despite that the term 'sale' is not an accurate legal description; the use of the term 'sale' in this Chapter would mean the process of disposing of the assets by the originator regardless of the legal mechanism being used to accomplish such sale.

[112] *See* Oditah, *supra* note 2, at 2 referring to MACLEOD, PRINCIPLES OF ECONOMICAL PHILOSOPHY, (1872), at 481: "...if we were asked-who made the discovery which has most deeply affected the fortunes of the human race? We then, after full consideration we might safely answer – the man who first discovered that a debt is a saleable commodity".

[113] *See, e.g.*, FREDDY SALINGER, FACTORING LAW AND PRACTICE, (Sweet & Maxwell, 1995).

[114] The following discussion owes much to Nick Foster and his thorough research in the area of law of transfers. *See generally*, Nick Foster, *Transfers of Rights and Obligations in the UAE: A Comparative Analysis in the Light of English Law, French Law and the Shari'a*, 7 YEARBOOK ISLAMIC & MIDDLE EASTERN L. 3, (2000 -2001), 3-13.

rights and 2) personal rights.[115] *Real rights* are those rights that relate directly to a thing,[116] such as a house. Unlike real rights, personal rights are those rights which "derive their 'existence' from the possibility of an action against a person"[117] whether a natural person or a legal person.[118] *Personal rights* can derive from different sources such as contract and tort.

Foster gives us an example to illustrate, if a seller sells a house to a buyer; nothing happens to the house itself. What happens instead is that a transfer of a *real right* from the seller to the buyer takes place.[119] As a result, the buyer will have all the *rights* to enjoy using the house. However, a sale of the securitised receivables is a sale of debt and hence it involves the transfer of *personal rights*.[120] According to Foster, the securitised receivables are *personal rights* because these rights: "1) relate to future property of the creditor, property which the holder of the right does not have in his or her possession or control; 2) relate to indeterminate property such as money; and 3) are specifically tied to the counterparty's ability to pay".[121] Thus, "a receivable is not a sum of money belonging to the creditor but in the possession of the debtor. Yet the liability of the debtor to fulfil his obligation is a *thing*, a valuable one at that, capable of being dealt with like any other intangible property".[122]

However, these receivables or debts as *personal rights* are referred to as 'choses in action'.[123] *Choses in action* or a 'thing in action'[124] is a term that lawyers have had

[115] *Id.* at 7.
[116] Foster, *supra* note 114, at 7.
[117] *Id.* at 7.
[118] JOANNA BENJAMIN ET AL., THE LAW OF GLOBAL CUSTODY, at 9 (Butterworths Lexis Nexis, 2002).
[119] Foster, *supra* note 114, at 7.
[120] Debt is a personal right *see* BENJAMIN ET AL., *supra* note 118, at 9.
[121] Foster, *supra* note 114, 8-9 listing three elements which distinguish a personal right from a real right.
[122] Oditah, *supra* note 2, at 32.
[123] MARTIN HUGHES, SELECTED LEGAL ISSUES FOR FINANCE LAWYERS, at 71 (LexisNexis UK, 2003).
[124] *Id.*

difficulty in defining.[125] It refers to a property that does not have any physical existence but it can be enforced by action in courts.[126] In a conclusion, the sale of the securitised assets in a securitisation transaction is the transfer of these choses in action or the transfer of the property rights. Such rights constitute a chose in action under English law.[127]

3.2 THE LAW OF TRANSFERS: DEFINITION AND SOURCES OF HOSTILITY

A "securitisation-friendly" legal framework is one that provides, *inter alia,* for transparent and effective laws to facilitate transferring the securitised assets. As will be explained, there are various legal techniques in order to accomplish transferring the receivables under English law. However, different legal jurisdictions have different legal attitudes towards the law of transfer. Various reasons, which have been outlined in Foster's study, play a role in having these different legal attitudes towards transfers.

Generally speaking, a transfer is a three party transaction and it involves the following scenario.[128] Assume one is involved in two loan transactions. First, creditor (A) lends a borrower (B) £100. Second, (B) the borrower in the first transaction lends (C) £100. So, (A) has the *right* to receive and claim his £100 from (B). Likewise, (B) has the *right* to receive and claim his £100 from (C). (B) might be interested to transfer his right to receive the money from (c) in favour of (A). In this sense, (B) is a transferor and (A) is a transferee.[129].

[125] *Id.* at 70.
[126] *Id.* at 71.
[127] RAVI TENNEKOON, THE LAW AND REGULATION OF INTERNATIONAL FINANCE, at 105 (Butterworths, 1991)(referring to *Torkington v. Magee* [1902] 2 KB 427).
[128] This scenario is based on the legal mechanism of assignment.
[129] Linguistically, the term "transferee" or "assignee"referes to the new holder of the "right" being the new "creditor". The *Majalla* uses different meaning. *See infra* note

The loan in the second transaction is a debt owed to the creditor (B) and hence it constitutes a *personal right* which can be transferred.[130] (B) has no other obligations towards (C) (*e.g.*, more loan advances); and hence a transfer transaction would involve a transfer of a *right* rather than an *obligation*. Under English law, another legal mechanism effects the transfer of obligations. As explained in the previous section, securitisations involve the transfer of *personal rights* rather than obligations. As will be seen in the next section, this can be achieved through *assignment* under English law.

However, different legal traditions have different legal attitudes towards the issue of transfer. According to Foster, such attitudes are the result of different influencing factors that have been identified to be:[131] 1) false wealth, 2) changing creditors, 3) excessive litigation, 4) total transfers, 5) sale at a discount, 6) delay in receipt of assets, 7) involvement of the debtor, 8) certainty problems and 9) the conceptual basis of the relationship. The "false wealth" factor is generally associated with the grant of non-possessory security.[132] Thus, if a creditor lends a debtor an amount of money in return for security collateral without taking possession of this security, the debtor may appear wealthy by having possession of the security. The debtor might use this appearance of wealth in order to deceive other creditors.[133] This applies to the transfer of receivables.[134]

---

[130] Whether such right can be transferred is subject to local law.
[131] Foster; *supra* note 114, at 15-16. *See also* Nick Foster, *An Unstoppable Force Meets a Movable Objects? Assignment of Rights in UAE*, 19 ARAB LAW QUARTERLY 169 hereinafter *An Unstoppable Force Meets a Movable Objects?*]; Nick Foster, *Owing and Owning in Islamic and Western Law*, paper presented at the Sixth Harvard Forum on Islamic Finance [hereinafter *Owing and Owning*] (Foster refers to PHILIP WOOD, COMPARATIVE LAW OF SECURITY AND GUARANTEES, (Sweet & Maxwell, 1995) for the first four factors).
[132] WOOD, *supra* note 131, at 33.
[133] Foster; *supra* note 114, at 16.
[134] *Owing and Owning*, *supra* note 131, at 14.

A second factor is the "creditor-debtor relationship". Thus, if the law allows the transfer without the consent of the debtor it deprives the debtor from choosing his creditor.[135] Hence, the debtor may be faced with a hostile creditor.[136] A third factor is the excessive litigation which might result from the transfer of rights because it is tantamount to trading in claims.[137] Excessive litigation might lead to a large amount of claims before the courts, influencing negatively on the effectiveness of the administration of justice.[138] This is because the transferees might be more likely to pursue claims than the original creditors.[139]

A fourth source of hostility towards transfers is the objection to the idea of a "total transfer",[140] which is the transfer of all the receivables present and future.[141] The reason behind such objection is to protect the weak from being under the excessive ongoing control of the financial power of another person.[142] Other sources of hostility have been identified by Foster in his studies on the transfer of rights. For example, the objections to the sale at a discount and delay in the receipt of assets are sources of hostility towards transfer of rights. This example applies to the Islamic *Shari'a*, because it may give rise to issues related to *riba*.[143]

Another source of hostility is associated with the certainty required by a specific legal jurisdiction. Because the receivables being transferred have no physical existence, they are less certain comparing to other physical assets.[144] This may cause

[135] Foster; *supra* note 114, at 16.
[136] WOOD, *supra* note 131, at 33.
[137] Foster; *supra* note 114, at 17.
[138] *Id.*
[139] *Id.*
[140] *Id.*
[141] *Owing and Owning*, *supra* note 131, at 15.
[142] Foster, *supra* note 114, at 17-18.
[143] *See* Chapter One on *riba*.
[144] *Owing and Owning*, *supra* note 131, at 15.

a problem in some legal jurisdictions.[145] Finally, another factor of hostility towards transfers could be the difficulty to construct a suitable conceptual framework which deals with the relationship between the debtor, the creditor and the property.[146]

These factors may have contributed in inhibiting the development of the transfer laws. However, these general sources of hostility should not be seen as having a universal application.[147] The aim of the foregoing discussion was to give a brief overview of possible reasons for the different attitudes towards transfers. In circumventing the hostilities towards assignment that exist in some legal jurisdictions, specific laws will need to be enacted to facilitate the transfer of receivables.

3.3 LEGAL TECHNIQUES FOR THE SALE OF RECEIVABLES

As mentioned, there are three main techniques (under English law) that are used to sell loan assets: namely, assignment, novation and sub-participation.[148] In case of an assignment, the assignor transfers to a third-party or the assignee its rights against the debtor.[149] Thus, in a securitisation transaction, the originator or the 'selling institution' by means of assignment transfers its rights against the borrower or the obligor[150] to the established SPV. Hence, the SPV will have the right to recover the principal and interest from the obligors as well as the right in suing them for

[145] *An Unstoppable Force Meets a Movable Objects?*, *supra* note 131, at 8 (referring to the French Civil Code Art. 1129).
[146] *Owing and Owning*, *supra* note 131, at 15.
[147] *Id.*
[148] In this section, novation and assignment are discussed. Sub-participation does not in law constitute a transfer of rights or obligations; it is used however, as a mechanism for the sale of receivables. *See* TENNEKOON, *supra* note 127, at 108. The description of such mechanisms is discussed in the light of the common-based law countries such as English law.
[149] CRANSTON, *supra* note 65, at 356.
[150] Obligors are the debtors of the originator.

collection.[151] In this sense, an assignment is an exception to the legal concept of the "privity of contract".[152]

Under English law, such assignment can be effected into two ways: namely, legal assignment and equitable assignment.[153] Legal assignment can be effected under the provisions of section 136(1) of the Law of Property Act 1925. Legal assignment is valid when it meets the requirements stated in section 136(1). Hence, it must be in writing,[154] it must be 'absolute' and not by way of charge,[155] and a written notice must be given to the debtor/obligor.[156] Practically speaking, some requirements may render the use of legal assignment unattractive as a mechanism to sell assets.[157] For example, the originator or the 'selling institution' may not want the obligor to know that the right to the receivables has been assigned to the assignee.[158] This is because the originator or the 'selling institution' wishes to maintain the relationship with the obligors.[159] Another reason for the impracticality is that the originator wishes to assign only part of the debt.[160] Such is not possible under legal assignment.

Another possibility under English law is to use the mechanism of *equitable assignment*. An equitable assignment is an assignment that does not have to meet the above-mentioned requirements of legal assignment. Hence, an equitable assignment provides a suitable and practical mechanism for the sale of receivables in a

[151] The buyer will acquire the full legal and beneficial interest in the debt and may not need the seller in enforcement. *See* Neil Cuthbert, *Assignment and Participation of Loans*, *in* PRACTICAL LENDING AND SECURITY PRECEDENTS, Volume (2), at I005 – I006.
[152] CRANSTON, *supra* note 65, at 356.
[153] The availability of two forms of assignment (*i.e.*, legal and equitable) is due to the historical fact of the existence of courts of law and courts of equity with different views on assignment and before the enactment of the Supreme Court of Judicature Acts 1873 and 1875.
[154] Law of Property Act 1925 (LPA), Sec. 136(1).
[155] *Id.* Also, assignment must be of the whole debt; as section 136(1) does not cover the assignment of part of the debt. *See Foster v Baker* [1910] 2 KB 636 and *Williams v Atlantic Assurance Co Ltd* [1933] 1 KB 81, CA. *See also*, Hughes, *supra* note 123, at 75.
[156] LPA, Sec. 136(1).
[157] TENNEKOON, *supra* note 127, at 107.
[158] *Id.*
[159] WOOD, *supra* note 75, at 51. *See also* CRANSTON, *supra* note 65, at 361.
[160] TENNEKOON, *supra* note 127, at 107.

securitisation transaction. For example, equitable assignment is effective with no written notice to the obligors.[161] So, receivables are assigned to the SPV using the equitable assignment.[162] However, it is important to note that under the assignment mechanisms (*i.e.*, legal or equitable), it is possible to assign the rights and not the obligations. Thus, the originator can assign the right to the principal and interest but not the obligation to extend further advances.[163]

Novation is another transfer mechanism whereby an existing contract is substituted by a new one with the consent of all the parties.[164] In effect, a new contract is entered between the three parties; that is, the "selling institution", the "buying institution" and the borrower. Strictly speaking, this is not an assignment of the existing contract; rather it is an extinction and replacement with a new contract.[165] Unlike assignment, under the novation structure both rights and obligations are transferred.[166] Thus, when receivables are transferred by means of novation; the 'buying bank' acquires direct rights against the borrower and all the benefits of the loan agreement. Also, all continuing obligations of the 'selling bank' are transferred to the 'buying bank'. However, the borrower has to agree to such a transfer.[167]

3.4 THE LEGAL INFRASTRUCTURE FOR SECURITISATION

Given the benefits of securitisation to the overall financial system, it is suggested that financial-related legal reforms in an emerging economy such as Saudi Arabia should include a basic asset securitisation law.[168] Such law would play an important

[161] *Id.*
[162] CRANSTON, *supra* note 65, at 361.
[163] *Id.* This is relevant in revolving credit facilities.
[164] CRANSTON, *supra* note 65, at 355.
[165] *Id.* at 388.
[166] *Id.*
[167] This is in contrast with equitable assignment where no consent of the borrower is required.
[168] NORTON, *supra* note 1, at 50.

role in facilitating securitisation transactions to be completed effectively. Hence, a number of countries have addressed the issue of securitisation in a formal way. Turkey, for example, has addressed securitisation in its capital market law. Other countries such as Tunisia have included the concept of securitisation in its plan to develop its banking sector,[169] and Lebanon has finally introduced a securitisation law.[170]

The existence of a specific securitisation law is not an absolute pre-requisite to structure securitisation transactions. It is important, however, that the legal infrastructure as a whole allow certain legal elements to facilitate the securitisation process and to encourage its market. Thus, the absence of a proper legal framework is proven to be an impediment to many emerging market countries willing to develop their securitisation markets.[171]

Firstly, a "securitisation-friendly" legal framework should not prevent the practice of securitisation by disallowing banks or corporations from participating in the capital market.[172] Secondly, the legal framework should allow the creation of SPVs in order to facilitate the transfer of receivables to these entities.[173] Also, SPVs should be allowed to issue securities under the local law.[174] It should be noted, however, that certain structures have been used successfully by using offshore SPVs.[175] Thirdly; a well-developed bankruptcy and insolvency laws are important.[176]

---

[169] Nasri Antoine et al., *MENA – GCC Securitisation Market Review*, at 2 ; *available at* http://www.bemosecuritisation.com
[170] *See* Iad Boustany et al., *Asset Securitisation in Lebanon: a New Legal Framework*, *in* GLOBAL SECURITISATION, *supra* note 22, 280.
[171] NORTON, *supra* note 1, at 258.
[172] *Id.* at 259.
[173] *Id.*
[174] *E.g.*, Under the Saudi law, SPVs are not allowed to issue securities; *see infra* Section 5.2.
[175] NORTON, *supra* note 1, at 259. *See also* Manuela Belmontes, *Using the Cayman Islands and other Offshore Jurisdictions for Securitisation Transactions*, 10(2) J. STRUCTURED FIN 36, (2004) (discuses several elements which should exist in the jurisdiction where the SPV is going to be formed. He argues that the efficiency of securitisation is maximised when the SPV is formed in a jurisdiction

A creditor-friendly insolvency law is well-suited framework for securitisation transactions.[177] The law should be clear regarding the bankruptcy remoteness of the SPV. A bankruptcy remote SPV is essential in a securitisation transaction so it is not affected in case of the originators' insolvency.

Finally, but not any less significantly, a securitisation-friendly legal framework should have a modern secured transactions law and a modern commercial law that recognises the sale of receivables. Transferring the originator's assets is crucial to the securitisation process. Hence, the law should allow the transfer of assets and receivables. The law should be modified to allow the transfer of such assets easily with no complications on 'true-sale' basis.

Given the importance of *assignment* as the primary legal mechanism for receivables financing[178] and for the transfer of receivables in securitisation transactions, the United Nations Commission on International Trade Law (UNCITRAL) introduced the Convention on the Assignment of Receivables in International Trade (the Convention).[179] The aim of the Convention is to make uniform the law regarding assignments in order to enhance the legal certainty and to increase receivables-based finance[180] including securitisation.[181] Reports by the UNCITRAL[182] show that the differences in assignment laws and the lack of

which does not impose any additional tax costs to the transaction (*i.e.*, tax neutrality), a jurisdiction which its legal framework ensures the bankruptcy-remoteness of the SPV, a jurisdiction which is recognised by the rating agencies and a jurisdiction with a familiar and creditor-friendly legal regime).

[176] NORTON, *supra* note 1, at 259.

[177] Belmontes, *supra* note 178, at 39.

[178] Spiro Bazinas, *An International Legal Regime for Receivables Financing: UNCITRAL's Contribution*, 8 Duke J. Comp & Int'l L 315, at 315, (1998).

[179] *See generally* http://www.uncitral.org

[180] Bazinas, *supra* note 178, at 320.

[181] Spiros Bazinas, *Multi-Jurisdictional Receivables Financing: UNCITRAL's Impact on Securitisation and Cross-Border Perfection*, 12(2) Duke J. Comp & Int'l L 365, at 365, (2002).

[182] Bazinas, *supra* note 178, at 318 (referring to reports which were prepared by the Secretariat of the UNCITRAL).

developed rules constitute obstacles to receivables financing.[183] While the Convention is intended to address international rather than domestic transactions;[184] it reflects the importance of having clear assignment laws in order to transact receivables financing and securitisation successfully.

While no international consensus has evolved in respect of the underlying legal framework that governs assignment law to transact securitisation effectively, the following practical requirements should be taken into consideration:

- The existing transfer legal mechanism; or assignment should effect the transfer of rights rather than obligations;
- The transfer by way of assignment should be on a 'true sale' basis and should not be re-characterised as a secured loan; and
- There should be no requirement to give a notice to the obligor.

While this is not meant to be an exhaustive list, it does include basic practical requirements which serve as an effective assignment laws suitable for securitisation transactions. These practical requirements are considered when discussing transfer laws within the Saudi legal system.

4. SECURITISATION IN SAUDI ARABIA AND THE IMPACT OF DUALITY

Securitisation is not only a new phenomenon in Saudi Arabia but also in the Arab and other G.C.C countries. There are indications of regional interest in securitisation transactions. For example, a conference on securitisation was organised in the United Arab Emirates, and is to be held as an annual event.[185] While GCC-governments are

[183] *Id.*
[184] Harry Sigman et al., *Toward Facilitating Cross-Border Secured Financing and Securitisation: An Analysis of the United Nations Convention on the Assignment of Receivables in International Trade,* 57Bus. Law. 727, at 729 (2002).
[185] The conference is held on 12-14 April 2005.

reported to be aware of the advantages of securitisation[186] such events will help to create a "financial lobby" that might influence the government to take the necessary steps for financial legal reforms to facilitate transacting securitisations in the region.

There is no doubt that emerging markets are facing specific challenges in developing their securitisation markets.[187] Saudi Arabia and the G.C.C countries are no exception. Certain challenges have been identified in the G.C.C countries, including Saudi Arabia that might constitute obstacles to the structured finance market in the region.[188] These include: (i) poor sovereign rating, (ii) existence of legal systems that cannot support a structured finance transaction even when the sovereign rating is investment grade and (iii) underlying political factors[189] (such political risks have been noted to be obstacles for securitisation in Saudi Arabia).[190]

Despite these obstacles, there are securitisation deals that have been concluded in the region such as Egypt and Saudi Arabia.[191] However, these deals may take a long time to be completed and may otherwise entail unnecessary burdens.[192] Thus, some deals have taken more than one year and others failed after two years of work.[193] Local players' unfamiliarity with this new financial technique may be one reason for such delay.[194] Hence, local players need to be educated along with developing the securitisation markets in the region.

---

[186] Leonora Walters, *Unlikely Markets Show Appetite*, 72 INT'L SECURITISATION REP. 31, 2002, at 31.
[187] *See generally* Jain, *supra* note 5.
[188] Iad Boustany et al., *Islamic and Conventional Securitisation: Challenges and Opportunities for SMEs*, at 2 *in* GLOBAL SECURITISATION REVIEW (2004-2005) (Euromoney Yearbooks).
[189] *Id.*
[190] Walters, *supra* note 186, at 31.
[191] Boustany et al., *supra* note 188, at 2.
[192] *Id.*
[193] *Id.*
[194] Walters, *supra* note 186, at 31.

A common feature that all emerging markets share is being "bank centric" with underdeveloped equity and bond markets.[195] Likewise, the legal infrastructure in these countries is underdeveloped. This is true in the case of Saudi Arabia, though the new Saudi legal reforms aim to address this issue. As discussed in Chapter Two, the government of Saudi Arabia intends to develop its equity and bonds markets. This is why the new Capital Market Law (CML) has been introduced. Such law is believed to encourage bond issuing and to stimulate the securitisation process. While such legal reforms are positive steps to facilitate such modern financial techniques; the CML does not work in isolation. The overall legal system of Saudi Arabia is the Islamic *Shari'a* and the CML is a part of this overall legal system.

The effectiveness of these laws needs to be examined in the light of the *existing de facto duality*. The author has endeavoured throughout the previous Chapters to highlight how the interaction between Islamic *Shari'a* and modern economy has implications on the effectiveness of the conventional financial systems. In addition, the argument has been that these implications have created a trend towards developing "Islamic finance". In this Chapter, the aim is to examine this theme by focusing on securitisations due to, other than the personal interest of the author, the growing interest in the region.

In Saudi Arabia, the *existing de facto duality* has two impacts on securitisation transactions. First, many principles of the Saudi Islamic law are in contradiction with the conventional securitisation technique. For example, conventional securitisations involve the sale of interest-bearing assets that are unacceptable under Islamic *Shari'a*. Hence, such contradictions may affect the functionality of the securitisation and may create an uncertain legal environment, rendering the aims intended for

[195] Jain, *supra* note 5, at 206.

encouraging securitisation fruitless. Such uncertainty is leading to a second impact that is a positive one. The financial and legal communities in Saudi Arabia are circumventing the present obstacles by developing the market of Islamic securitisation.[196] Such initiatives are solely private and not regulated or governed by the government.

However, developing the Islamic securitisation market is not the sole solution for introducing securitisations to the Saudi financial system. Thus, as explained in Chapter Two, conventional banking is recognised in Saudi Arabia. In other words, Saudi Arabia does not maintain a pure Islamic financial system. There could be the case that conventional banks would be interested to securitise certain assets or to offer this service to other institutions. Hence, developing an Islamic alternative for the securitisation technique is insufficient for a mature financial system that encompasses conventional banking. There is no indication that Saudi Arabia is aiming to "Islamise" the whole financial system; and therefore, the government might consider the advisability of encouraging both Islamic and conventional securitisations in Saudi Arabia and to provide a securitisation-friendly legal framework to accommodate such transaction whether Islamic or conventional.

The rest of this Chapter aims to discuss the obstacles that currently face conventional securitisations in Saudi Arabia. Arguably, such obstacles are the result of the *existing de facto duality* in Saudi Arabia which allows a conventional financial system to function within an Islamic law body. This Chapter also shows how the Saudi financial and legal communities reacted by developing Islamic securitisation techniques.

[196] *See* the discussion of "Islamic securitisation" *infra*.

4.1 PRINCIPLES OF ISLAMIC *SHARI'A* LAW AND SECURITISATION

As discussed previously, the paramount legal system in Saudi Arabia is the Islamic *Shari'a*. Within this Islamic law body, Saudi Arabia has allowed a conventional financial system to function. It introduced both the Banking Control Law and the Capital Market Law to regulate the banking sector and the capital market but there are no other banking and financial related laws. Hence, any legal vacuum may be filled by the Islamic *Shari'a*, the legal practice and the contributions of the committees such as the Banking Disputes Settlement Committee or the Securities Disputes Committee[197] that have been created to deal with financial related disputes. However, such committees render their decisions only in case of dispute. Such decisions are normally unpublished, so it is hard to constitute a readily available, transparent body of law in relation to the banking and finance communities.[198]

The question that might be posed is whether the Saudi legal system, even after the recent legal reforms, constitutes a viable legal framework that accommodates modern financial transactions such as securitisation. In order to answer such question, one has to analyse the Saudi legal system to see what are the implications that might result when embarking on a securitisation transaction in Saudi Arabia. Generally speaking, in conventional securitisation transactions there are several elements that might be in contradiction with the paramount legal system of Islamic law in Saudi Arabia. One issue is the nature of the assets being securitised or the underlying assets, which should be in compliance with Islamic *Shari'a*.[199] Assets

---

[197] *See* Chapter Two.
[198] However, in Islamic law precedents are not binding.
[199] Iad Boustany, *Market Review for the MENA/GCC Region, in* GLOBAL SECURITISATION REVIEW (2003-2004) at 75 (Euromoney).

prohibited by the Islamic *Shari'a*, include interest-bearing assets[200] such as credit card receivables and mortgages. Hence, Islamic *Shari'a* does not allow the sale of such assets.

In practice, however, the dual nature of the Saudi legal system may cause confusion in this regards. While the issue of interest is completely prohibited by Islamic *Shari'a* and interest cannot be enforced through the Islamic *Shari'a* courts, the Committee for Settlement of Banking Disputes does enforce the agreements as signed between the banks and their borrowers, which imply enforcement of interest. So, the sale of interest-bearing debts in conventional securitisations could be allowed. In other words, having allowed a conventional banking system to function and to extend interest-bearing credit, there is no practical reason why there should be an objection to the sale of interest-bearing assets in securitisations.

Islamic *Shari'a* is objections to conventional securitisation are not confined to the nature of the underlying assets being securitised. The securitisation transaction itself, in substance, should comply with the Islamic *Shari'a*.[201] In other words, the agreements linking the parties in the securitisation transaction must be in compliance with the Islamic *Shari'a*. Arguably, in order for securitisation to comply with Islamic *Shari'a*, the structure should match with one of the Islamic financing techniques such as *murabaha* and *ijara*.[202] Thus, Islamic *Shari'a* holds a different view regarding investments and profit-making. Under Islamic *Shari'a*, financing is linked to assets[203] and investors must 'participate' in the assets on a "profit and loss" basis.[204]

---

[200] *Id.*
[201] *See* Antoine, *supra* note 169, at 4; Boustany et al., *supra* note 188, at 5.
[202] Boustany, *supra* note 199, at 75.
[203] MUHAMMAD USMANI, AN INTRODUCTION TO ISLAMIC FINANCE, at xiv (Kluwer Law International, 2002) (explains that as far as Islamic *Shari'a* is concerned money is not to be considered as an asset. Hence, when we refer to Islamic finance as linked to assets it means something which has intrinsic utility which can be sold for money. Money has no intrinsic utility and it is only a medium of exchange).

In other words, investors must share some risk in return for any profits.[205] So, Islamic *Shari'a* requires adopting one of the Islamic financing techniques in securitisation transactions that entitle the investor to an ownership or an equity interest in the assets and that justifies any returns to the investors.

Important points arise in relation to the above discussion as to the case of Saudi Arabia. Further, to adopt one of the Islamic financing techniques is completely a different means of financing. Islamic securitisation is a different technique developed as an alternative to conventional securitisation, due to the difficulty of structuring the former in Islamic-based countries such as Saudi Arabia. In other words, conventional securitisation can not be adapted to one of the Islamic financing techniques because it is a completely different structure. The two structures should not be confused. Another issue related to the Islamic-compatibility of the structure arise when trying to apply conventional securitisation in Saudi Arabia. This would be the question of whether Islamic *Shari'a* in Saudi Arabia can provide or allow for an efficient legal technique that can be used to accomplish the sale of the securitised assets on a 'true sale' basis. Such is essential in most securitisation transactions as previously discussed.

4.2 TRANSFER OF ASSETS IN SAUDI ARABIA: THE IMPACT OF THE *SHARI'A* LAW

The financial laws in Saudi Arabia do not address the transfer of assets, assignment or securitisation. The Saudi Capital Market Law is promulgated mainly to regulate the securities market. There are no clear or certain rules governing the issue of assignment or the transfer of rights. As Islamic *Shari'a* is the paramount Saudi legal system, it does constitute the legal background that affect any securitisation transaction. We should also bear in mind that any dispute resulting

[204] Nadim Khan, *Islamic Financing and Securitisation*, 6(2) FITAR 413, at 413, (2001).
[205] *Id.*

from the transfer of assets in a conventional securitisation transaction that is taking place in Saudi Arabia may not be referred neither to the Committee for Settlement of Banking Disputes nor to the Securities Resolution Committee.

Thus, if a Saudi non-bank originator wishes to transfer the assets to an SPV which is a company, such transaction may not be referred to the above-mentioned Committees.[206] At this juncture, it is more likely that Islamic *Shari'a* will be playing a dominant role, to deal with any dispute arising as to which legal technique can be used in order to accomplish the transfer of the assets. This section discusses the possible legal techniques available under the Islamic *Shari'a* to clarify the negative implications of the *existing de facto duality* on conventional securitisation. Prior to discussing these Islamic legal techniques, it is necessary to clarify the position of Islamic *Shari'a* towards personal rights.

4.2.1 THE SHARIA'S APPROACH TOWARDS RIGHTS IN SAUDI ARABIA

As discussed, the legal nature of the securitised assets is considered *personal rights* or "choses in action" as opposed to *real rights*. Clearly, these personal rights by their nature should be treated as property that can be transferred and used as security collateral. Under Islamic *Shari'a,* however, the underlying assets in a securitisation transaction should be in compliance with Islamic *Shari'a* principles. This means that it should not be interest-bearing assets or receivables that are generated by prohibited transactions under Islamic *Shari'a*. The question one might pose is whether the securitised assets as *personal rights* are recognised under the Saudi Islamic *Shari'a*.

[206] *See* Chapter Two.

The distinction between *real rights* and *personal rights* is not known under Islamic *Shari'a.*[207] Islamic *Shari'a* recognises a different type of distinction; namely, the distinction between *'ayn* and *dayn.*[208] *'Ayn* is defined as "a specific existing thing, considered as a unique object and not merely as a member of a category".[209] The basic meaning of *dayn* is debt.[210] It can also be defined as "any property, not an *'ayn*, that a debtor owes, either now or in the future; or it can refer to such property only when due in the future".[211] So, under Islamic *Shari'a* a property (*mal*)[212] can be owned as either *'ayn* or *dayn.*[213] Unlike *'ayn*, a *dayn* has no physical existence and hence Islamic *Shari'a* considers the *dayn* as property existing in the '*dhimma*' of the debtor.[214] Literally, *dhimma* means safekeeping, protection and responsibility.[215] Legally, *dhimma* is the "capacity in an individual by which he accepts duty and obligation".[216]

Dhimma is the main element that distinguishes *'ayn* from *dayn* under Islamic *Shari'a.*[217] However, the distinction between *'ayn* and *dayn* is not tantamount to the distinction between *real rights* and *personal rights.*[218] Thus, *personal rights* are broader than *dayn* because *dayn* is one form of *personal rights.*[219] Having clarified

---

207 Al-Sanhuri, *Masadir Al-Ḥaqq fi Al-Fiqh Al-Islami* (The Sources of Rights in Islamic Jurisprudence) at 15, (Dar Al-Hana, 1954) (In Arabic). Also Foster, *supra* note 114, at 41.
208 Foster, *supra* note 114, at 41.
209 FRANK VOGEL ET AL., ISLAMIC LAW AND FINANCE: RELIGION, RISK, AND RETURN, at 94 (Kluwer Law International, 1998).
210 Foster, *supra* note 114, at 41. Debts is the literal meaning of dayn but in Islamic jurisprudence the word dayn refers to the property subject to the obligation and not to the obligation *per se*, see VOGEL ET AL., *supra* note 209, at 94.
211 VOGEL ET AL., *supra* note 209, at 94.
212 Property or *mal* has a different meaning under Islamic *Shari'a. Mal* is defined as "tangible things to which human nature inclines". For *mal* to be the subject of the contract it has to be lawful under the Islamic *Shari'a* (*i.e., mutaqawwam*); *see* VOGEL ET AL., *supra* note 209, at 94.
213 VOGEL ET AL., *supra* note 209, at 94.
214 *Id.* 95.
215 *Id. See also* MUHMMAD QUALAJI ET AL., DICTIONARY OF ISLAMIC LEGAL TERMINOLOGY, at 191 (Dar An-Nafaes, 1996).
216 *Id.*
217 Al-Sanhuri, *supra* note 207, at 15.
218 *Id.* at 14.
219 *Id.*

the position of the Islamic *Shari'a* law towards *real* and *personal* rights, it can be concluded that despite its different approach towards rights, a *dayn* can still be considered as one form of *personal rights* or 'choses in action' under Islamic *Shari'a*. Therefore, from an Islamic *Shari'a* perspective a conventional securitisation transaction in Saudi Arabia would involve the transfer of the right of repayment of a *dayn* (debt) or the originators' debts in the *'dhimma'* of the obligors to the SPV.

4.2.2 THE LAW OF TRANSFER IN SAUDI ARABIA: THE HAWALA CONCEPT

So far, it is clear that the overall legal system in Saudi Arabia is Islamic *Shari'a*. Other financial related laws are mostly supervisory in nature and there are no clear laws that govern specific financial transactions. Hence, Islamic *Shari'a* provides the source for the law of transfer. It is at this juncture where Islamic *Shari'a* interacts with conventional securitisation transactions. In Saudi Arabia, one of the main legal techniques of transfers, under Islamic *Shari'a*, is the Islamic *hawala*. In order to transact conventional securitisations in Saudi Arabia effectively and with certainty, the technique of *hawala* should pass the practical requirements, for effective assignment law, laid down previously in this Chapter. The conformity of the technique of *hawala* with these requirements is one of importance. This is because *hawala* might be a means of transfer, but not to the level that meet the requirements of achieving a successful securitisation transaction. In other words, the mere availability of a transfer technique is not sufficient.

Discussing the concept of *hawala* under Islamic *Shari'a* is not free of obstacles. The reason is that the different Islamic *Shari'a* schools have different views as to the concept itself. Even within the same school there could be different opinions. The diversity among schools as to the interpretation and understanding of the concept of *hawala* adds another dimension of uncertainty. Although the *Hanbali* School is the dominant school in Saudi Arabia; the following discussion considers other schools also for two reasons. Firstly, it helps in a better understanding of the concept itself. Secondly, the dominance of the *Hanbali* School in Saudi Arabia does not preclude considering other schools.

Literally, *hawala* means "transfer" and it is translated as the "transfer of debt".[220] The *Majalla*[221] defines *hawala* as making "a transfer of debt from one debtor account to the debtor account of another".[222] There is no doubt that difficulties associated with the translation might affect the precise understanding of the *hawala*. Thus, 'the debtor account' is meant to be the translation of the '*dhimma*' explained in the previous Section. The Arabic version defines *hawala* as "the transfer of debt from *dhimma* to another *dhimma*".[223] At any case, *hawala* involves shifting the responsibility from one to another. We need to go through other definitions mentioned in the *Majalla* in order to analyse the concept of *hawala* in the light of the practical requirements laid down previously. The *Majalla* defines the transferor as the debtor who makes the transfer.[224] The transferee is the person who accepts the transfer to himself.[225] However, the "creditor" is the person in whose favour the debt is transferred.[226] Under English assignment law, in a conventional securitisation, the

[220] *See* THE CIVIL LAW OF PALESTINE AND TRANS-JORDAN (Volume 1), at 161[hereinafter THE CIVIL LAW OF PALESTINE] (C. A. Hooper trans., Azriel Printing Works, 1933) which is the translation of the *Majalla/Mejelle* (the Ottoman code based on the *Hanafi* School).
[221] *See* Chapter One on the *Majalla*
[222] THE MEJELLE BEING AN ENGLISH TRANSLATION OF MAJALLAHEL-AHKAM-I-ADLIYA AND A COMPLETE CODE ON ISLAMIC CIVIL LAW, art. 673 [hereinafter THE MEJELLE] (Tyser et al. trans., Law Publishing Company, 1901; reprint 1967).
[223] SALEEM RUSTOM, *SHARH AL-MAJALLA*, art 673 (Explanation of the *Majalla*) (Al-Matba'a Al-Adabiyya, 1923) [in Arabic].
[224] *Id.* art. 674.
[225] *Id.* art. 676. *See also* THE MEJELLE, *supra* note 222, art. 676.
[226] THE CIVIL LAW OF PALESTINE, *supra* note 220, art. 675.

SPV would be the transferee/assignee. However, under the *hawala* the "transferee" is the "obligor" rather than the SPV (*i.e.*, the originator's debtor).[227]

Foster explains that different sources provide different definitions of *hawala* which leads to a confusion in relation to the *hawala* concept.[228] These definitions are the result of different translations of the *hawala*. There is no need, however, to go through these different translated definitions of *hawala*. Rather it is better to go deeper than that by analysing the legal principles and rules behind the definition itself. A viable starting point for this discussion is to see whether *hawala* involves the transfer of rights or obligations. As mentioned previously, one of the practical requirements for a good securitisation assignment law is the existence of a legal mechanism that effects the transfer of rights rather than obligations.

The issue of *hawala* and whether it involves transfer of rights or obligations is a subject that has not been dealt with by Islamic Scholars of the main four Islamic Schools. This issue has been raised recently when the *hawala* concept has been studied comparatively with other legal systems.[229] Thus, Sanhuri has studied the concept of the Islamic *hawala* from a civil law-based perspective and he divides assignment into two types, namely; "assignment of a right" and "assignment of a debt". Sanhuri explains that "assignment of a right" is a mechanism that involves a transfer of a *right* from a creditor to another creditor whereas "assignment of a debt" is a mechanism that involves a transfer of an *obligation* from a debtor to another debtor.[230]

[227] The following discussions of the *hawala* are based on the *Majalla* definitions.
[228] Foster, *supra* note 114, at 48 (referring to differences between the definition of *hawala* in the old edition of the Encyclopaedia of Islam and the new one).
[229] *See generally* ABDUL RAZIQ AL -SANHURI, *AL-WASIT FI SHARH AL-QANUN AL-MADANI AL-JADID*, Vol. 3 (1950); Foster, *supra* note 114.
[230] AL -SANHURI, *supra* note 229, at 413 (refers to the 'assignment of right' as *cession de créance* and the 'assignment of debt' as *cession de dette*. In the Egyptian civil law there is a clear distinction between both assignments).

As mentioned earlier, securitisations involve the transfer of rights. Also, transfer of assets in securitisation transactions involves a transfer from creditor (*i.e.*, originator) to another creditor(s) (*i.e.*, SPV/bondholders). Hence, under Sanhuri's distinction of assignments, securitisation would fall under the "assignment of a right" category. Under English law, assignment is not categorised as "assignment of a right" or "assignment of a debt". In English law, assignment is a legal mechanism which effects the transfer of rights only and no obligations can be transferred through assignment.[231] For convenient, however, these categories are referred to in the rest of this Section.

Hawala itself is divided into two types: 1) *restricted hawala* (*hawala muqayyada*) and 2) *unrestricted hawala* (*hawala mutlaqa*).[232] The *Majalla* defines the *restricted hawala* as a transfer "restricted by a stipulation for the transferee to pay from property of the transferor owed to him by the transferee".[233] The *unrestricted hawala*, on the other hand, is defined as a transfer that "is not restricted for payment to be made from property of the transferor in the hands of the transferee".[234] Foster proposes a presumption, which he rebuts later in his study, that the *restricted hawala* has been perceived as a mechanism that effects the transfer of *rights* while the *unrestricted hawala* effect the transfer of *obligations*.[235] It is a "presumption" because there is no mention in the *Majalla* of whether *hawala* is a transfer of a right or an obligation.

[231] Ross Buckley, *The Law of Emerging Markets Loan Sales: Part 1*, 14(4) J.I.B.L 110, at 111, (1999) (referring to *Tolhurst v. Associated Portland Cement Manufacturers (1900) Ltd* [1902] 2 KB 660).
[232] THE MEJELLE, *supra* note 222, arts. 678 & 679. However, such distinction only exists under the *Hanafi* School.
[233] THE MEJELLE, *supra* note 222, art. 678.
[234] *Id.* art. 679.
[235] Foster, *supra* note 114, at 47.

Foster's presumption in the light of Sanhuri's distinction between "assignment of a right" and "assignment of a debt" would mean that *restricted hawala* is an "assignment of a right" whereas *unrestricted hawala* is an "assignment of a debt". Such, however, is a plausible presumption. Thus, in the *restricted hawala*, the transferor limits the transfer in the amount of money owed to him by the transferee. Hence, it can be argued that it is a *prima facie* presumption that the transferor is transferring his *right* to his creditor. As for the unrestricted *hawala*, the transferee is required to pay from his own money.[236]

Proceeding with his analysis of *restricted hawala*, Foster correctly argues that the *restricted hawala* is in fact a mechanism for the transfer of an *obligation* and not a mechanism for the transfer of a *right*.[237] He explains:

> "In our terms the limited [restricted] *hawala* is only possible where the new obligation of the transferee ... is the same as his old obligation...It is also necessary for the obligations to be of the same type. The consent of all three parties is necessary...It is these characteristics which give the false impression that *hawala* is a transfer of right mechanism...This is not the case. The basis for the transaction is still the transfer of an obligation, not the transfer of a right".[238]

Foster concludes that both types of *hawala* are mechanisms to transfer obligations rather than rights. Hence, *hawala* is *not* tantamount to the English assignment mechanism because *hawala* is at the heart of the transfer of an obligation.[239]

[236] THE MEJELLE, *supra* note 222, art. 678. *See also* RUSTOM, *supra* note 223, at 378 (explains that the transferee after paying from his own account can claim repayment from the transferor. If the transferee owes money to the transferor; the transferee can set-off against the debt).
[237] Foster, *supra* note 114, at 47-48.
[238] *Id.* at 48.
[239] *Id.* at 44.

Since Foster has been discussing the concept with generalisation and with no reference to a specific Islamic school, the above statement needs to be further analysed in the light of the main four Islamic schools.[240] In the above statement if both obligations should be the same as stated, this means that Foster is relying on the *Hanbali, Malaki or Shafi* Schools (hereinafter Group A) because this is a *must* in these schools.[241] If this is so, and contrary to Foster's statement, there is no need that all parties should consent to the transfer as in these Islamic schools, the consent of the creditor and the transferor is sufficient without the need for the transferee's consent.[242] On the other hand, in the *Hanafi* school (hereinafter Group B), the consent of all the parties is required[243] *but*, and again contrary to Foster's statement, there is no need that both obligations should be the same.[244]

Nevertheless, Foster's conclusion that *hawala*, whether *restricted* or *unrestricted*, is a mechanism for the transfer of an obligation is practically an appropriate conclusion. Thus, Sanhuri has explained the position of *hawala* in Islamic law by stating that the use of term *hawala* in Islamic law is always referring to the "assignment of a debt" rather than the "assignment of a right".[245] In other words, *hawala* is in fact a mechanism for the transfer of *obligations* rather than *rights*. The term "assignment of a right" is not known to Islamic scholars.[246] In Islamic law, "assignment of a right" is referred to as the "sale of debt".[247]

[240] Foster, *supra* note 114, at 39.
[241] Sanhuri, *supra* note 229, at 428 -429.
[242] *Id.* at 429.
[243] *Id.* at 422. Under the *Hanafi* School, the consent of all the parties is required in the *restricted hawala* only.
[244] *Id.* at 424 n.1.
[245] *Id.* at 422.
[246] *Id.*
[247] *Id.*

Using the terminology of the *Majalla*, the transfer of assets in securitisation transactions is confined to the repayments owed by the obligors (*i.e.*, transferees) to the originator (*i.e.*, transferor).[248] Hence, it is a similar scenario to that of the *restricted hawala*. Therefore, it is more relevant to discuss *restricted hawala* in this Section excluding *unrestricted hawala*. It is also significant to consider both Islamic Groups (*i.e.*, Group A and Group B) in more detail to ensure the conclusion that *hawala* is in fact a mechanism that transfers obligations rather than rights.

Restricted hawala is the only type which is recognised by Group A as *hawala*.[249] For Group A, the *unrestricted hawala* is a form of suretyship.[250] As mentioned earlier, Group A recognises *restricted hawala* provided that the obligations are of the same type and the amount owed by the transferor to the creditor must be the same amount owed by the transferee to the transferor.[251] Such circumstances might appear to be transfer of *rights* rather than *obligations*. Thus, the transferor has the right to receive an amount of money from the transferee: and instead of receiving such amount of money from the transferee; the transferor transfers his right to his creditor. In concurrence with Foster's conclusion, however, this is not the case. In such scenario, it is an *obligation* that is being transferred and not a *right*. Thus, the transferor has met his obligation towards his creditor by way of "renewal".[252] A new debt, a new obligation and a new debtor (*i.e.*, the transferee) have replaced the old ones.[253]

---

[248] Using the *Majalla* terminology.
[249] Sanhuri, *supra* note 229, at 428.
[250] *Id.* at 433.
[251] *Id.* at 428.
[252] Sanhuri, *supra* note 229, at 432 (uses the Arabic term *tagdeed* which means to renew. However, the author avoids using the term 'novation' so it is not confused with such mechanism under English law).
[253] Sanhuri, *supra* note 229, at 432.

Sanhuri mentions the main reasons, based on his analysis of the views of Group A, why the *restricted hawala* can be considered to be a transfer of an obligation rather than a transfer of a right. Thus, in case there is a security collateral or a guarantee given by the transferee to the transferor in their loan arrangement, such security/guarantee, in the opinion of Group A, is not transferred to the creditor when *restricted hawala* takes place.[254] Hence, Sanhuri infers that what has been transferred is an obligation and not a right. This is because, if a right is transferred, the security/guarantee should have been transferred as well. In other words, the relationship between the transferor and the transferee is vanished. Similarly, the relationship between the transferor and the creditor is vanished. Also, the security/guarantee given by the transferee to the transferor is vanished too. A new obligation is created whereby the transferee is obliged to pay the creditor.[255] Hence, the transferee is the new debtor of the creditor.

Further, the creditworthiness of the transferee is another element which Sanhuri relies on to justify his opinion that *restricted hawala* involves a transfer of an obligation and not a right. For Group A, if the transferee is insolvent at the time of the transfer or becomes insolvent after the transfer by *restricted hawala*, the transferor is not obliged to pay any amount to the creditor because he is already dropped out of the picture. Sanhuri argues that, if *restricted hawala* involves transfer of a right, the creditor should have been able to have recourse to the transferor for repayment. However, this is not the case in the view of Group A and, hence, one reaches the conclusion that *restricted hawala* is a means to transfer obligations.

We turn now to consider the opinion of Group B in regards to the *restricted hawala* to see if it involves the transfer of rights or obligations. Generally, it can be

[254] *Id.* at 430 & 432.
[255] *Id.* at 432.

argued that Group B agrees with Group A that *restricted hawala* involves a transfer of an obligation.[256] Again, in case of the *restricted hawala*, the security/guarantee given by the transferee to the transferor is not transferred. So, it is a similar conclusion that of Group A. The only main difference with Group A is that this new obligation that is created by the *restricted hawala* can be terminated by the creditor if he was unable to receive his money.

From the above discussion, it can be argued that in the opinion of both Groups A and B, the *restricted hawala*, is a mechanism to transfer obligations rather than rights. Hence, *restricted hawala* does not pass the first practical requirement mentioned earlier for a good assignment law, necessary to achieve the transfer of rights in securitisation transactions. Now we move to consider the second practical requirement of the criteria discussed previously, the mechanism of *restricted hawala* should achieve a total transfer, and such transfer should not be recharacterised or terminated. This is because in securitisation transactions, there must be a complete legal strong separation between the originator and the SPV. Securities holders should have no recourse to the originator. In case of *restricted hawala*, this means that the creditor should have no recourse to the transferor, after being transferred to the transferee.

The following considers again the opinions of both Groups in this regard. For Group A, if the creditor is transferred to the transferee, the creditor will no longer be able to have recourse to the transferor for repayment. A new obligation has been created where the transferee is obliged to pay the creditor and the transferor is completely dropped out of the picture.[257] One exception is where the transferor by

[256] However, some scholars within Group B reaches the conclusion that *restricted hawala* is a form of security or guarantee/suretyship.
[257] Samurai, *supra* note 229, at 431.

way of deception has agreed to the transfer with the knowledge that the transferee is insolvent.[258] For Group B, the creditor will still have recourse to the transferor and is able to claim his money from the transferor even after the transfer.[259] In other words, in the opinion of Group A, there is a higher level of total transfer achieved, as opposed to the opinion of the Group B where total transfer is not achieved by means of *restricted hawala*. Hence, the opinion of Group A seems to be in concurrence with the third practical requirement, as opposed to the opinion of Group B.

Finally, the third proposed practical requirement requires that the transfer can take place without the consent of the transferee. So, the originator should be able to transfer its rights to the SPV without the consent of the obligors. Again, Group A and Group B have different opinions in this regards. For Group A, there is no need for the consent of the transferee in the *restricted hawala*.[260] This is because in the view of Group A, it is essential in *restricted hawala* that the amount owed by the transferor to the creditor should be exactly the same as the amount owed by the transferee to the transferor. Hence, Group A argues that there is no problem in transferring the obligation to the transferee without his consent because the transferee is not harmed in any way as he is obliged to pay the same amount in any case.[261] For Group B, the position is the opposite. Group B requires the consent of the transferee if the *restricted hawala* to be a valid transaction.[262] Hence, one can see that Group A passes the second practical requirement, whereas Group B fails to meet such requirement.

---

258 *Id.*
259 *Id.* at 427.
260 Sanhuri, *supra* note 231, at 429.
261 *Id.*
262 THE MEJELLE, *supra* note 222, art. 682. *See also* RUSTOM, *supra* note 223, at 373; THE CIVIL LAW OF PALESTINE, *supra* note 220, at 162.

Having discussed *restricted hawala* in light of the practical requirements proposed in this Chapter, it can be concluded that *hawala* is not a legal mechanism that can achieve the sale of assets in a modern securitisation transactions. Such conclusion highlights the implications of the *existing de facto duality* on financial transactions, such as securitisation in Saudi Arabia.

5. ISLAMIC SECURITISATION IN SAUDI ARABIA

The growing Islamic banking and finance techniques and structures are a positive reaction to create a functional equivalent system that achieves the mobilisation of resources and funds. The driving force behind such initiatives is the Islamic position towards conventional financing. Such position had forced the financial community to create its own alternative in order to meet the needs of the investors and the borrowers. However, the growing activities of the Islamic finance sector have necessitated further innovations of Islamic structures and techniques.

In the light of this, the financial community has developed an "Islamic securitisation" structure in order to diversify assets pools, to raise capital and to convert illiquid assets into marketable securities. As will be seen in this Section, "Islamic securitisation" has penetrated to the Saudi financial market. It can be argued that the use of "Islamic securitisation" in Saudi Arabia is partly attributed to the fact that there is an *existing de facto duality*. This means that the impact of the *existing de facto duality* on conventional securitisation has led the market to invoke other *means* in order to circumvent clashes with the Islamic *Shari'a* through transacting Islamic-compliant products.

5.1 THE EVOLVING CONCEPT OF ISLAMIC SECURITISATION: AN OVERVIEW

The creation of an "Islamic securitisation" alternative does not mean its similarity to the conventional securitisation. In Chapter One, the Islamic financial techniques have been outlined. This section provides an overview of how such techniques are being used in "Islamic securitisations". Islamic securitisation practitioners have identified the following issues that should be taken into consideration when transacting an Islamic-compliant securitisation:[263]

1. The type of assets must be acceptable to Islamic investors;
2. The structures that are used must be acceptable;
3. A sufficient element of ownership must be conveyed to comply with Islamic principles governing asset sales and assignments; and
4. Any form of credit enhancement must be in permissible form.

The nature of the securitised assets is a major difference between Islamic and conventional securitisations. As explained earlier, the securitised assets should be in compliance with the Islamic *Shari'a*. This means that interest-bearing assets cannot be securitised. In addition, while Islamic *Shari'a* encourages the trading of tangible assets (*i.e.*, *'ayn*), it prevents the trading of *dayn*.[264] Generally, this includes contingent or future rights.[265] So, "Islamic securitisation" is an *asset-based* rather than *asset-backed* securitisation.[266] This means that Islamic securitisation as an "Islamic finance" product is based on "money- for-assets" rather than "money-for money".[267] So, Islamic *sukuk* (*i.e.*, bonds) issued by the SPV in Islamic securitisation

---

[263] Suleiman Abdi Dualeh, *Islamic Securitisation: Practical Aspects, available at* http://www.guidancefinancial.com
[264] VOGEL ET AL., *supra* note 209, at 172. However, the Malaysian school has different interpretations in this regards.
[265] *Id.*
[266] ADAM ET AL, *supra* note 27, at 61.
[267] Mahmoud El-Gamal, *Interest and the Paradox of Contemporary Islamic Law and Finance*, 27 FORDHAM INT'L L. J. 108, at 129, (2003).

transactions are not *backed* by the assets (*i.e.*, not secured). Rather, the *sukuk* represent ownership interests in the assets. Assets in "Islamic finance" should be *'ayn* with physical existence.[268]

Vogel illustrates this point by stating that Islamic securitisation works as "securitisation and trading of interests in tangible, known property... For example, one could gather investors potentially to buy an office building jointly and lease it for twenty years, issuing securities representing their interests. Because these interests represent co-ownership of a building, they could be freely traded".[269] It is important to remember, however, in Vogel's example, that the securities should represent an undivided part of the asset (*i.e.*, the office building) with all its rights and obligations.[270] Any securities that represent the holder's right to claim certain amount of rental only without any ownership rights in the asset is not allowed under Islamic *Shari'a*.[271]

5.2 THE DIFFERENT TYPES OF SUKUK IN ISLAMIC SECURITISATIONS

Islamic securitisations can be structured in different ways. The nature of the assets being securitised or the project being financed will dictate the nature of the relevant Islamic securitisation structure. Islamic securitisations are normally based on one of the "Islamic finance" techniques discussed in Chapter One or in certain transactions; it could be based on a combination of two "Islamic finance" techniques. Therefore, the title of the *sukuk* structure will be named after the "Islamic finance" technique being used. Thus, *sukuk al-ijara* refer to the fact that the *ijara* technique is used as the basis for the Islamic securitisation transaction.

[268] However, there is an exception as will be explained *infra*.
[269] VOGEL ET AL., *supra* note 209, at 172.
[270] El-Gamal, *supra* note 267, at 133.
[271] *Id.*

Although *sukuk al-ijara* structure is one of the most commonly used structures in the Islamic finance industry, there are however other structures such as *sukuk al-musharka, sukuk al-mudaraba* and *sukuk al- istisna*. These structures are based on the "Islamic finance" techniques of *musharka, mudaraba* and *istisna* respectively. However, the *sukuk* industry is becoming more complex which has led certain countries and the Islamic finance standards-setters, as will be seen in Chapter Five, in introducing certain standards and regulations that would help in regulating the issuance of these *sukuk*. The following aims to introduce briefly these Islamic *sukuk* structures.

5.2.1 SUKUK AL-IJARA

The "sukuk al-ijara" is the most commonly used structure in the Islamic finance industry.[272] Many governments find the structure of *sukuk al-ijara* useful to raise funds for their fiscal needs and long-term financing of big projects.[273] Equally, corporate also finds this structure useful for fund sourcing purposes to meet their project specific needs.[274] While the advent of *sukuk al-ijara* have involved high costs relating to the rating expenditures, legal documentations, underwriting and investment banking services; the increased use and awareness of this product have brought these costs to a reasonable level.[275]

A simplified asset-based securitisation based on an Islamic-compliant leasing (*i.e., ijara*)[276] can be summarised as follows:[277]

[272] McMillen et al., *supra* note 22, at 40.
[273] SALMAN ALI, ISLAMIC CAPITAL MARKET PRODUCTS: DEVELOPMENTS AND CHALLENGES, Occasional Paper No. 9, at 28 (Islamic Research and Training Institute, Islamic Development Bank, 2005).
[274] *Id.*
[275] *Id.*
[276] *See* ISLAMIC CAPITAL MARKET: REPORT OF THE ISLAMIC CAPITAL MARKET TASK FORCE OF THE INTERNATIONAL ORGANISATION OF SECURITIES COMMISSIONS, July 2004, at 37 [hereinafter ISLAMIC CAPITAL MARKET] *available at* http://www.iosco.org

1. The originator whose the owner of an asset or group of assets (*e.g.*, office building(s))[278] sells the asset to an SPV with the understanding that the SPV will lease the asset back from the SPV.[279]
2. The SPV raises financing to purchase the asset by issuing *sukuk al-ijara* for sale to investors. The amount raised by issuing the *sukuk* is equal to the purchase price.[280] *Sukuk al-ijara* represent an equity interest in the SPV and undivided shares in the ownership of the asset being purchased.[281]
3. The SPV leases the asset back to the seller *(i.e., originator)*.[282] The seller makes periodic lease payments to the SPV, which represent the returns to the investors (*i.e., sukuk* holders). Hence, the rent proceeds should match the SPV's obligations under *sukuk al-ijara.*[283]
4. At maturity, the rent flow will stop and the ownership of the asset would still be with the *sukuk* holders.[284] However, the investors' objective is to invest their money but not to own a particular asset. The aim of the originator, on the other hand, is to have financing for a particular period of time. Thus, the originator does not wish to dispose of its asset permanently.

   Therefore, to meet both objectives of the investors and the originator; the SPV sells the asset back to the originator (*i.e.*, lessee or previous

---

[277] *See* Standard & Poors, *A Closer Look at Ijara* Sukuk, 2 February 2005 [hereinafter *Closer Look at Ijara*] *available* at http://www.standardandpoors .com.
[278] Of course other assets can be considered.
[279] ALI, *supra* note 273, at 30. However, the rent will be negotiated and it is normally calculated on the LIBOR basis.
[280] *Closer Look at Ijara, supra* note 277.
[281] ALI, *supra* note 273, at 31.
[282] *Id.* (the SPV can lease the assets to an affiliate of the seller).
[283] *Id.*
[284] ALI, *supra* note 273, at 31.

seller/owner of the asset). The amount should cover any other liabilities owed by the SPV under the *sukuk al-ijara*.[285]

While such structure is normally referred to as "Islamic securitisation", this term should not be confused with conventional securitisation as practiced by non-Islamic institutions. Securitisation in Islamic finance is better referred to as "monetisation" of the underlying assets.[286] Trading with bonds in conventional securitisation involve the transfer of personal rights attached to receivables by way of equitable assignment. In Islamic securitisation, however, personal rights to a certain extent are not involved because Islamic *sukuk* are undivided ownership in specific assets. While the sale of conventional bonds is a sale of debt, the sale of *sukuk* is a sale of shares of an asset.[287] So, the trading of *sukuk* in Islamic securitisation is a sale of *'ayn* (transfer of a real right) rather than a transfer or sale of *dayn* (transfer of a personal right).

However, it is not usually the case that the originator owns a physical asset only. The originator might own assets consist of both physical asset (*i.e.*, *'ayn*) and other receivables in the form of cash (*i.e.*, *dayn*). The question we might pose is whether the originator can securitise such pool of assets in an Islamic compliant manner? In this regards the Islamic *Fiqh* Academy (IFA),[288] a subsidiary organ of the Organisation of Islamic Conference (OIS),[289] has issued an Islamic opinion allowing

[285] *See* ALI, *supra* note 273, at 31(explaining the *Shari'a* issues related to the final stage (*i.e.*, the sale of the asset back to the originator). The main issue arises in relation to such sale is whether the asset should be sold back to the originator at market value or at the nominal value of the *sukuk*. Certain *Shari'a* opinions hold the view that the asset should be sold at market value only). However, in practice the *Shari'a* committees have allowed for the assets to be sold to the originator at the nominal value of the *sukuk*. This would allow for repayment of the principal paid by the *sukuk* holder when purchasing the actual *sukuk*.

[286] ADAM ET AL, *supra* note 27, at 109 n.9.

[287] *Id.* at 53.

[288] *See generally* http://www.fiqhacademy.org. *See also* Chapter Five.

[289] *See generally* http://www.oic-oci.org. *See also* Chapter Five.

such pool of assets to be securitised provided that the pool consist of at least 51% in tangible assets.[290]

While "*sukuk al-ijara*" is the most widely used structure in the Islamic finance industry there are still some limitations.[291] Thus, some originators do not have the appropriate underlying assets that can be securitised in a *Shari'a* compliant manner[292] (*i.e.*, because it requires tangible assets).[293] Also, the assets should be locked up in the structure during the term of the *sukuk*.[294] In addition, in certain jurisdictions there are adverse tax consequences associated with introducing "*sukuk al-ijara*" structure.[295]

These limitations, however, are by no means deterrents to the development of the *sukuk* markets or the use of "*sukuk al-ijara*" structure. The Islamic finance industry is developing and attempts to provide solutions to expand the activities of these Islamic capital market products. For example, the *sukuk* market hardly existed prior to 1997.[296] In addition, the increased awareness of "Islamic finance" would definitely contribute towards facilitating theses "Islamic finance" products and would eliminate any extra costs that could result from the particulars of an "Islamic finance" product. For example, in the UK; legislations have been introduced to ensure that "Islamic

[290] Decision 5, forth session (1988), *Fiqh Academy Journal* , 3, 2161, at 2163. The decision asserts that (a) any combination of assts that can be represented in a written note or bond, and (b) this bond or note can be sold at a market price provided that the composition of the group of assets, represented by the bond, consists of a majority of physical assets and financial rights, as compared to a minority of cash and interpersonal debts. A combination of the following of assets can be securitised: 1) physical assets, 2) financial rights, 3) interpersonal debts and 4) money.
[291] McMillen et al., *supra* note 22, at 405.
[292] *Id.*
[293] Kamalpour et al., *supra* note 22, at 222.
[294] *Id.*
[295] McMillen et al., *supra* note 22, at 405.
[296] *E.g.*, the "*sukuk al-ijara*" structure was first introduced in 1997. *See* ALI, *supra* note 273, at 28.

finance" products are not at a tax disadvantage as opposed to their conventional finance counterparts.[297]

5.2.2 SUKUK AL- MUSHARKA

The "*sukuk al-musharka*" is a structure which is based on the *musharka* concept. Under this structure, the SPV, acting on behalf of the *sukuk* holders (*i.e.*, investors), enters into a joint venture or "*musharka*" agreement with the party seeking financing (*i.e.*, the borrower).[298] In doing so, the SPV through the issuance of *sukuk* contributes into the *musharka* by providing the financing whereas the party seeking financing makes an in-kind contribution (usually including some tangible assets).[299] Both the SPV and the party seeking financing are parties to the *musharka* and their respective interests in the *musharka* are represented by contractual "Units" held by each party.[300]

However, the main purpose of the financing provided by the investors through the SPV is to invest the money rather than to own a specific asset through a *musharka* arrangement. Hence, the investors should be able to receive profit distributions. In order to achieve this purpose, "*sukuk al-musharka*" need to be structured in a way that make it possible for the investors to dispose of the "Units" that are owned by the investors through the SPV as part of the *musharka* arrangement. Therefore, the SPV enters into a "Purchase Undertaking" with the party seeking financing.[301]

[297] Two Acts were introduced, namely; the Finance Act 2005 and Finance Act 2006. However, these Acts have not referred to "Islamic finance" structures expressly. Instead, different terminology is used such as "Alternative Finance Return" and "Diminishing Shared Ownership".
[298] Strictly speaking, from an Islamic finance legal perspective the party seeking financing can not be referred to as borrower.
[299] Kamalpour et al., *supra* note 22, at 222.
[300] *Id.*
[301] *Id.*

Under the "Purchase Undertaking" the party seeking financing undertakes to buy the "Units" from the SPV.[302] The proceeds received by the SPV from the sale of the "Units" will be distributed to the investors in accordance with set a formulae.[303] In this way, the investors will receive their expected profits whereas the party seeking financing will gain complete ownership of the project that it aimed to get financed.

5.2.3 SUKUK AL-MUDARABA

As explained in Chapter One, the *mudaraba* structure is a form of partnership. One party provides the capital and the other party manages the money and contributes through its experience and effort. The concept of *mudaraba* can also be used in *sukuk* structures although is not very popular like the *ijara*.[304] Under the "*sukuk al-mudaraba*" structure, the SPV issues *sukuk* to the investors who are considered to be the sole capital providers. The party seeking financing will apply the proceeds of the *sukuk* issuance to finance the relevant project.

The party seeking financing is the *mudarib*. This means that it will only be required to use the proceeds and apply its relevant experience and effort with no further contribution. While the *mudarib* is still liable in case of negligence or misconduct the unpopularity of such structure is attributed to the fact it is a high risk.[305] From a legal perspective, the main difference between *musharka sukuk* and *mudaraba sukuk* that in the former the financier is entitled to management participation of the project being financed.

---

[302] *Id.*
[303] *Id.*
[304] McMillen et al., *supra* note 22, at 407.
[305] *Id.* at 407.

5.3 RECENT ISLAMIC SECURITISATION STRUCTURE IN SAUDI ARABIA

The *Caravan I Sukuk*[306] transaction involved one of the first "true sale" securitisations in Saudi Arabia.[307] The transaction has been voted as the "Most Innovative Islamic Finance Product" being the first Islamic *Shari'a* compliant inventory fleet securitisation in the G.C.C/MENA region.[308] The *Caravan I Sukuk* deal has a total size of SR102 million[309] and it is backed by a pool of vehicles and vehicle lease agreements purchased from the originator.[310] The originator is HANCO Rent-A-Car (HANCO) one of the leading car leasing and rental companies in Saudi Arabia[311] and it has a fleet over 4,000 vehicles.[312] HANCO's strategy aimed at restructuring its balance sheet in order to attain the necessary capacity to grow its business.[313] HANCO also aimed at shifting its focus from fleet ownership service (*i.e.*, balance sheet based) to a fleet management service.[314] HANCO had no access to a bank financing and suffered from continues mismatching.[315]

The financial technique of securitisation offered a method to achieve the above strategies and to circumvent the lack of financing dilemma faced by HANCO. Through securitisation, HANCO was able to inject cash into the company, to solve the mismatching and to achieve its strategy in refocusing the business on servicing activities.[316] However, because HANCO is operating in Saudi Arabia, the securitisation transaction is structured within an Islamic *Shari'a* body. This means

[306] *Caravan I Sukuk* is the name of the securitisation deal.
[307] Bowman, *supra* note 24, at 24.
[308] *See generally* http://www.bemosecuritisation.com
[309] Around US $ 27.20 million.
[310] http://www.bemosecuritisation.com
[311] ADAM ET AL., *supra* note 27, at 15.
[312] Bowman, *supra* note 24, at 24.
[313] *CARVAN I SUKUK* : THE FIRST *SHARI'A* COMPLIANT SECURITISATION (Workshop – Securitisation World April 2005- Part I), at 12 *available at* http://www.bemosecuritisation.com
[314] *Id.*
[315] *Id.* at 14.
[316] *Id.* at 25.

that HANCO faces certain dilemmas in structuring a conventional securitisation transaction. In order to circumvent such dilemmas, an Islamic securitisation structure based on the issuance of Islamic *sukuk* has been devised to meet HANCO's needs.[317]

Hence, *Carvan I Sukuk* is an Islamic securitisation transaction based on securitisation of inventory rather than a classical securitisation of receivables.[318] This means that the duties of the Servicer (*i.e.*, HANCO) are not limited to the normal duties of the servicer in a conventional securitisation. Rather, HANCO's duties in the *Carvan I Sukuk* include operating the vehicles.[319] The underlying assets involved HANCO's inventory fleet comprising 2344 vehicles and leasing contracts.[320] A special securitisation structure has been innovated in order to circumvent the existing obstacles in the Saudi legal system. These obstacles include: 1) unavailability of trust laws, 2) corporate SPVs in Saudi Arabia are not allowed to issue securities; and 3) foreign entities are not allowed to lease vehicles or own the underlying assets in Saudi Arabia.[321] This means that it would be difficult for the *sukuk* to be sold to foreign investors.

In the light of this and in order to overcome these obstacles, *Carvan I Sukuk* is structured on a two tier basis, that is; it involved two entities: an SPC and an SPV. HANCO (*i.e.*, the originator) sold the assets to the SPC which is incorporated in Saudi Arabia as a limited liability company with two independent shareholders from HANCO.[322] As mentioned, the assets are mainly vehicles which mean that the sale involved a transfer of ownership of the actual physical assets as opposed to the sale

[317] *See generally* Bowman, *supra* note 24.
[318] *CARVAN I SUKUK* : THE FIRST *SHARI'A* COMPLIANT SECURITISATION (Workshop – Securitisation World April 2005- Part II), at 4 [hereinafter *CARVAN I SUKUK* II] *available at* http://www.bemosecuritisation.com
[319] *Id.*
[320] *Id.* at 6. (the vehicles are operated in the rental, limousine and leasing business).
[321] *Id.* at 10. *See generally* Trevor Norman, *Securitisation Structures within an Islamic Framework*, 102 INT'L SECURITISATION REP 21, (Supp. 2005).
[322] *CARVAN I SUKUK* II, *supra* note 318, at 20.

in a conventional securitisation which involves an assignment of receivables. Because the SPC is not allowed to issue securities; an SPV is incorporated as a limited liability company in the Island of Jersey. In sum, the aim of SPC is to provide a Saudi entity to own the assets in order to circumvent the prohibition of foreign ownership; and the aim of the SPV is to issue the necessary *sukuk* or securities because the SPC is not allowed to do so.

Clearly, the SPV (*i.e.*, the issuer) is not the owner of the assets. Hence, one of the challenges in the *Caravan I Sukuk* is the relationship between the SPC (*i.e.*, the owner of the assets) in Saudi Arabia and the SPV in the Island of Jersey. The relationship is structured in a way to avoid frustrating the transaction through, for example, consolidating the SPC with HANCO or with the SPV.[323] Therefore, the relationship between the SPV and the SPC is governed by the Funding Agreement whereby the Issuer (*i.e.*, SPV) grants a loan to the SPC.[324] Under the Funding Agreement, the SPC has no obligation to repay the Funding in full on or before 3 July 2009.[325] The SPC, however, has the obligation to repay the SPV a monthly Funding Repayment Amount and Funding Profit Sharing according to preset schedules but only if cash is available.[326] These schedules are based on financial modelling.[327] The SPC has also the obligation to pay the Funding in full immediately upon the reception of a notice that the securities (*i.e.*, *sukuk*) have become due and payable in full.[328]

[323] *Id.* at 13.
[324] *Id.* at 28.
[325] *Id.*
[326] *Id.*
[327] On the financial modelling of the structure and the calculations of the repayments, *see CARVAN I SUKUK* II, *supra* note 318, pp 34- 47.
[328] *CARVAN I SUKUK* II, *supra* note 318, at 28.

Under the Funding Agreement, the SPV may require the SPC to sell any vehicle if an event of default has occurred.[329] The SPC has been obliged to grant a power of attorney to an Agent chosen by the SPV with authority to sell the vehicles or to exercise any other rights upon receiving a written notice from the SPV.[330] In addition, a Servicing Agreement is entered between the SPC, HANCO and the Back-up Servicer. According to the Servicing Agreement, HANCO will have to operate, to service and to administer the vehicles.[331] As regards the issuing process, the SPV issues the *sukuk* which amount to USD 26.13 million.[332] The *sukuk* rank *pari passu* among themselves and they rank senior to any other instruments issued by the SPV.[333]

5.4 FINAL OBSERVATIONS

The development of "Islamic securitisation" is one product that reflects the current trend in developing "Islamic finance" as a *means* to circumvent the interaction between conventional finance and Islamic *Shari'a* requirements. Market players have been looking for Islamic-compliant financial products that provide liquidity and at the same time tradable in the secondary market. However, the question is whether this "Islamic securitisation" is in fact a "securitisation" mechanism.

Abradat explains that there has been confusion in the market regarding the concept of "Islamic securitisation".[334] According to him, while the above discussed Islamic-compliant structures are referred to as "securitisations", this is not really the

[329] The Funding Agreement states for a number of events of default including the failure of the SPC to comply with any of its obligations.
[330] *CARVAN I SUKUK* II, *supra* note 318, at 29.
[331] *Id.* at 49.
[332] *Id.* at 53.
[333] *Id.*
[334] Discussions with the author's work supervisor, Mr. Abradat Kamalpour is a partner and the head of the Islamic finance team at Dechert LLP, London.

case. The reason is mainly because in "Islamic securitisation" structures the underlying assets are not really transferred in the "conventional securitisation" sense. In "Islamic securitisations", the "originator" normally re-acquires the underlying assets after the maturity of the relevant *sukuk*. In this sense, it is not truly an "off-balance" financing which is a major element of structured finance.

In other words, one can not draw a clear distinction between an "Islamic securitisation" structure and the issuance of Islamic bonds. This distinction, however, is clearer in *conventional* finance. Hence, it is fair to argue that "Islamic securitisation" is similar to the issuance of bonds in conventional finance as opposed to conventional securitisations. Abradat adds that true "Islamic securitisation" structures are in the process of being developed by the Islamic finance industry. In the meantime, however, this means that the conventional finance component in Saudi Arabia continues to suffer from the *existing de facto duality* and its implications on securitisation transactions.

Similarly, the area of "Islamic securitisations" or "Islamic *sukuk*" lacks a definitive legal framework. Consider, for example, the "Risk Factors" Section of a Prospectus[335] for a recent *sukuk* issuance in Saudi Arabia. The Section deals with several risk factors relating to the *sukuk*. The "Risk Factors" quoted below reflect the uncertainty surrounding the *sukuk* issuance in Saudi Arabia. Thus, under a risk factor entitled "Governing Law, Jurisdiction and Enforceability" the Prospectus states:

> " The *sukuk* are governed by, and are to be construed in accordance with, the laws of Kingdom of Saudi Arabia and in accordance with the rules of the [*Shari'a*] as applied in the Kingdom of Saudi Arabia...In addition, [the Issuer] is not aware of any securities of a similar nature to the *sukuk* being

[335] *See* OFFERING CIRCULAR, *supra* note 26.

> the subject of adjudicatory interpretation or enforcement in the Kingdom of Saudi Arabia. Accordingly, it is uncertain exactly how and to what extent the *sukuk* ... would be enforced by a Saudi Arabian court or other adjudicatory authority".[336]

In addition, another risk factor under the heading "*Shari'a*" reads:

> "Prospective Holders should also note that although the [Issuer's *Shari'a* Supervisory Committee] has issued a pronouncement confirming that the *sukuk* ...are in compliance with *Shari'a* principles, such a pronouncement would not bind a Saudi court or judicial committee, including in the context of any insolvency or bankruptcy proceedings relating to the Issuer, and any Saudi court or judicial committee will have the discretion to make its own determination about whether the *sukuk*...complies with the *Shari'a* principles and therefore is enforceable or otherwise."[337]

The above quotations summarise the Saudi position in regards to the Islamic *sukuk*. They reflect the lawyers' opinions who drafted these risk factors as to the lack of definitive legal interpretations and rules for the Islamic *sukuk*. The discussion leads us to conclude that the current position of the Saudi financial legal system as it relates to financial transactions is as follows:

- Despite introducing the financial-related laws in Saudi Arabia, there is still an interaction between Islamic *Shari'a* and modern finance. An example is securitisation transactions and the difficulty of achieving a *rule-based* "true sale".
- As a result of the interactions between the Islamic *Shari'a* and modern finance; "Islamic *sukuk*" strutcutres have developed and found their inroads

[336] *Id.* at 8.
[337] *Id.* at 9.

to the Saudi financial system. This component of the financial system lacks a definitive legal framework.

The main aim, however, is to have a market-led financial system which is *rule-based* and maintains the "rule of law". This means that securitisations should be transacted with predictability, certainty and clear rules. The Saudi case does not seem to be in line with these objectives. Hence, the "combination" approach mentioned in Chapter Two would serve as a good cure for the current dilemma. Thus, to achieve a successful "conventional securitisation" transaction, the interaction between modern finance and Islamic *Shari'a* should be eliminated. On the other hand, "Islamic securitisation" can be transacted effectively through introducing a definitive legal framework that define and regulate its market. Here, the "combination" approach would mean developing the "Islamic finance" component of the Saudi financial system. In this case, it is the development of the Islamic *sukuk* market. It also means applying the "segregation" phenomenon adopted in the DIFC model. This means introducing laws that govern conventional securitisation that are *segregated* from the overall Saudi legal system of Islamic *Shari'a*.

6. CONCLUSION

The Chapter has examined an example that reflects the implications of the *existing de facto duality* in Saudi Arabia on financial transactions. It also shows that the enactment of the Capital Market Law in Saudi Arabia to facilitate the functioning of the capital market is not sufficient to provide a "securitisation-friendly" legal framework. Such law is supervisory in nature and does function within an Islamic law body. This means that there are tensions and conflicts between Islamic law principles and the practical requirements of securitisation transactions. This, in turn, affects the effectiveness of transacting securitisations in Saudi Arabia, and therefore losing the benefits and the advantages that securitisation can achieve are lost.

In addition, the concept of "Islamic securitisation" has penetrated the Saudi markets. "Islamic securitisation" is an example of the "Islamic finance" trend that has developed to avoid the "legal unrests" generated by the interaction between Islamic *Shari'a* and modern conventional finance. Despite its success, "Islamic securitisation" is functioning with no definitive legal framework and it is a product that can not be used by the conventional banks or other institutions that are dealing with different type of assets and structures in Saudi Arabia.

Having analysed securitisation transactions in the light of the *existing de facto duality*, it is plausible to argue that the *status quo* is unsatisfactory. The main aim is to transact Islamic and conventional securitisations in an atmosphere of knowledge and certainty in line with the principles of market-economy policies that Saudi Arabia has introduced. This can be achieved if the interaction between Islamic *Shari'a* and conventional securitisation is eliminated. Here, introducing the DIFC "segregation" phenomenon would serve as a good starting point. In addition, the "Islamic finance" component of the securitisation industry being "Islamic securitisation" or the issuance of *sukuk* should be further developed. This dual approach (*i.e.*, conventional and Islamic) would enable Saudi Arabia to link its capital market internationally as well as regionally with the G.C.C countries through developing Islamic *sukuk*.[338]

[338] Over the past five years the *sukuk* market has grown to USD 41 billion with USD 11 billion worth of issues coming from the G.C.C region. *See* William Rhode, *Reaching for the Sky,* 118 INT'L SECURITISATION REP 40, at 41, (2006). *See also* Babu Augustine, *Sukuk Listings in GCC Region to Exceed $20b*, BUSINESS TIMES, 28 October 2006 (mentioning that the G.C.C *sukuk* market is expected to exceed USD 20 billion by 2010).

CHAPTER FOUR

SECURITY COLLATERAL LAWS AND STRUCTURES IN SAUDI ARABIA: THE TENSION ARISING FROM THE SAUDI DUALITY

CHAPTER OUTLINE

1. INTRODUCTION

Adopting a market-based economy requires developing a legal infrastructure for secured transactions. Security collateral laws are of much importance in market economies.[1] The law relating to security collateral interests is highly relevant when governmental policies allow the market to function and creditors to extend credit and bear risks.[2] In practice, creditors are more comfortable to provide credit when there is a valid and enforceable security collateral to minimise their credit risk. The larger and the riskier the loan, the more likely that creditors are inclined to require a form of security collateral.[3] The secured creditor who has security interest in the debtor's assets has an advantage over any other creditor who is not secured.[4] In case of insolvency, the secured creditor should be able to recover its right in full ahead of the rest of any other creditor.[5]

The advantages of a developed secured transactions law are not only confined in facilitating lending transactions. Introducing developed and sound secured transactions laws should contribute positively to the overall economy.[6] That security collateral law can have an important contribution towards a country's economic growth. This has been recognised by the World Bank and other International

---

[1] KATHARINA PISTOR ET. AL., THE ROLE OF LAW AND LEGAL INSTITUTIONS IN ASIAN ECONOMIC DEVELOPMENT (1960-1995), at 153 (Oxford University Press, 1999).
[2] *Id.*
[3] John Simpson et al., *General principles of a Modern Secured Transactions Law, in* EMERGING FINANCIAL MARKETS AND SECURED TRANSACTIONS, at 144 [hereinafter EMERGING FINANCIAL MARKETS] (Joseph Norton et al. eds., Klwuer Law International, 1998)
[4] PAUL ALI, THE LAW OF SECURED FINANCE: AN INTERNATIONAL SURVEY OF SECURITY INTERESTS OVER PERSONAL PROPERTY, at 1 (Oxford University Press, 2002).
[5] Insolvency laws are also of great importance
[6] Heywood Fleisig, *Economic Functions of Security in Market Economy, in* EMERGING FINANCIAL MARKETS, *supra* note 3, at 35. *See also* R.C.C Cuming, *Modernising the Secured Financing Law of Developing Nations, with Particular Focus on the West Bank and Gaza, in* NEW DEVELOPMENTS IN INTERNATIONAL COMMERCIAL AND CONSUMER LAW, at 184 (J. Ziegel et. al. eds., Hart Publishing, 1998).

Financial Institutions.[7] Several studies indicate that reforming the laws relating to secured transactions have contributed in the increase of the GDP in the reforming country.[8] This is because reforming secured transactions laws increases the availability of credit and lowers the interest rate which has a positive economic impact.[9] Hence, it is believed that any economic-related reforms in any emerging market should include reforms to secured transactions laws.[10]

Moving from general to particular, security collateral laws are very significant for the Saudi economic-related reforms. As we have seen in this volume, the Saudi government is aiming to reduce the role of public banks, to privatise and to adopt market-oriented policies in order for the market to function.[11] This means that the domestic financial system as well as external capital providers will play a very pivotal role in extending credit to meet the developmental needs of Saudi Arabia. To encourage the availability of credit in Saudi Arabia, secured transactions laws should meet the expectations of both domestic and external capital providers.

In Saudi Arabia, however, there has always been a clash between conventional financing principles including modern security requirements and the overall legal system of Islamic *Shari'a*. In practice, this clash can be divided into procedural and substantive legal problems. Procedurally, for example, notaries have always refused to notarise security interests in favour of conventional banks on the ground that these banks deal with interest (*i.e., riba*) which is against Islamic *Shari'a*.[12] Substantively, it can be argued that the unavailability of some types of security collateral interests,

[7] Roy Goode, *The Changing Nature of Security Rights*, *in* EMERGING FINANCIAL MARKETS, *supra* note 3, at 1.
[8] *See generally* Fleisig, *supra* note 6.
[9] *Id.*
[10] JOSEPH NORTON, FINANCIAL SECTOR LAW REFORM IN EMERGING ECONOMIES, at 31 (BIICL, 2000).
[11] *See* Chapter Two.
[12] *E.g.*, notaries do not refuse notarising in favour of the Special Credit Institutions, mentioned in Chapter Two, because such banks do not deal with interest.

as will be discussed in this Chapter, constrains the ability to extend credit in the Saudi market.

There are three main consequences to the above obstacles. Firstly, the legal and financial communities have reacted by developing practices to circumvent the existing procedural obstacles in the Saudi security collateral law. Secondly, the legal and financial communities led by the law firms and their "legal work"[13] reacted by developing security structures to provide more confidence for the lenders. In other words, providing 'micro-solutions' for 'macro-problems'. An example for such structure is the Islamic "*rahn adl*"[14] which has been developed to be used as a "collective security arrangement"[15] in financial transactions.[16]

Thirdly a final reaction, as argued in this Chapter, is the growing "Islamic finance" practice as a *means* of financing that might offer some form of security collateral in certain transactions especially when the financers have ownership of the assets being financed.[17] Other forms of "Islamic finance", however, may not require a "high level" of security in the conventional sense simply because "Islamic finance" is based on "risk-sharing".[18] At the procedural level, using Islamic-compliant

[13] *See* Doreen McBarnet, *Transnational Transactions: Legal Work, Cross-Border Commerce and Global Regulation*, *in* TRANSNATIONAL LEGAL PROCESSES, at 98 (Michael Likosky et al. eds., Butterworths, 2002) (defines "legal work" as the "technical work, with and on the law, undertaken usually but not necessarily by lawyers, in specific transactions for specific clients").

[14] The *adl* is a third party holding the security collateral.

[15] *See* A. THIELE, COLLECTIVE SECURITY ARRANGEMENTS: A COMPARATIVE STUDY OF DUTCH, ENGLISH AND GERMAN LAW, at 1 (Kluwer Legal Publishing, 2003) (defines collective security arrangement as: "an arrangement whereby security is held for the common benefit of a number of lenders").

[16] In common law based countries security trustees are involved in the collective security arrangement. However, the absence of the concept of trust in other countries led to developing other concepts.

[17] For example Islamic financing through *ijara* (leasing); *see* Chapter One. This argument has been inspired by Wood's argument that countries which are hostile to security have been receptive to title finance such as finance leases. Title finance shares some aspects with Islamic finance concerning the ownership of the assets. *See* Philip Wood, *World-Wide Security – Classification of Legal Jurisdictions*, *in* EMERGING FINANCIAL MARKETS, *supra* note 3, at 42

[18] However, structures have been developed in a way to provide the economic benefits tantamount to conventional finance and create incentives for the borrower to meet his obligations. For example,

financing in Saudi Arabia would mean circumventing any procedural obstacles that are associated with notarising security collateral interests by conventional banks. In other words, obtaining the necessary financing with no hassle.

However, the government of Saudi Arabia has not overlooked the importance of security collateral law. Recently, Saudi Arabia enacted a new security collateral law which deals with movables.[19] Such law has confirmed the willingness of the Saudi government to create a market-oriented legal framework to facilitate the development of a market-led financial system. Nevertheless, the positive contribution intended by the enactment of this law could be undermined if there is a failure in adapting and reconciling this new law with the overall Saudi legal system as will be discussed later in this Chapter.

In line with the volume's theme, this Chapter focuses on secured transactions as an example of the *existing de facto duality* and argues that the Saudi conventional finance component is still constrained being a system that functions within an Islamic *Shari'a* body. The Chapter also argues that despite using an alternative *means* to provide financing through "Islamic finance"; such means of financing lack a definitive legal framework.

This Chapter, therefore, suggests that in order to create a market-led financial system, secured transactions laws in Saudi Arabia need a further attention. Saudi Arabia is, therefore, advised to develop its exiting system following the "combination approach" as will be discussed in Chapter Five. This means developing a secured transactions law that serves the conventional finance component which is *segregated* from the overall legal system. At the same time, Saudi Arabia can

certain clauses maybe inserted in the agreements requiring the borrower to pay a certain amount to a reputable charity if the borrower fails to meet its obligations towards the lender.

[19] COMMERCIAL *RAHN* LAW, ROYAL DECREE NO. M/75, (21/11/1424 H) (hereinafter *Rahn* Law) *available at* http://www.moc.gov.sa

develop the "Islamic finance" component that would serve an alternative *means* of financing.

2. THE IMPORTANCE OF SECURITY AND SECURED TRANSACTIONS LAW

Extension of credit is considered to be "an engine of economic growth".[20] Both creditors and debtors are expecting profits from such extension.[21] Therefore, transactions should be structured in a profitable way for both parties.[22] Creditors consider a transaction profitable when debtors repay the extended loan.[23] In any financing transaction, creditors will be concerned about the non-payment risk. If creditors believe that the non-payment risk is high, extension of credit may not take place.[24] However, raising the interest charged on the loan, as a compensation for the high risk taken by the creditors may not be a very practical solution because the transaction must be profitable for the debtor as well.[25]

Bearing the parties' needs in mind (*i.e.,* the creditor and the debtor), 'credit enhancement' structures have been developed to achieve the aim of having a profitable transaction for both parties.[26] Generally, credit enhancement is "the art of structuring a transaction, through economic agreements and legal mechanisms, so that the transaction is seen by both the creditor and the debtor as prospectively profitable".[27] Clearly, credit enhancement is a mechanism which creditors invoke to be protected against the risk of non-performance and to maximise their recovery in

[20] Neil Cohen, *Internationalising the Law of Secured Credit: Perspectives from the U.S. Experience,* 20(3) U. PA. J. INT'L ECON. L 423, at 428, (1999).
[21] *Id.*
[22] *Id.*
[23] *Id.*
[24] *Id.* at 429. However, this will depend on the borrower and the studies undertaken by the bank in relation to the credit extension transaction.
[25] *Id.*
[26] Neil Cohen, *Harmonising the Law Governing Secured Credit: The Next Frontier,* 33TEX. INT'L L. J 173, at 174, (1998).
[27] *Id.*

case of the debtor's insolvency. This protection can be divided into two main mechanisms: 1) granting of collateral to the creditor by giving the creditor a security interest over assets, and 2) arranging any type of guarantees available from any secondary obligors or guarantors.[28]

In addition, taking a security interest serves other functions as well as maximising the prospect of recovery.[29] The second reason for taking security by the creditor is to gain control over the debtor's asset.[30] Taking a security interest in the debtor's asset constrains the debtor from having exclusive control over that asset.[31] This means that it is more likely that the debtor pays the secured creditor prior to the other general creditors in order to avoid losing an asset which is important for the debtor.[32] Moreover, it is argued that taking security would save the creditors from undertaking a lengthy and costly investigation as to the debtor's financial circumstances.[33]

Hence, clear rules and laws that govern security interests give the creditor a level of comfort to extend credit, to finance projects and to engage in different commercial and financial transactions. So, the availability of a sound secured transactions law is necessary because contract law is insufficient to be the sole legal framework for secured transactions.[34] Cohen argues that the insufficiency of contract law to provide a legal framework for secured transactions is based on three reasons.[35] Firstly, a security-holder's claim of a security interest is not only against the debtor but also against other third parties who are not party to the contract between the creditor and

[28] Guarantees and suretyships are outside the scope of this Chapter.
[29] GERARD MCCORMACK, SECURED CREDIT UNDER ENGLISH AND AMERICAN LAW, at 7 (Cambridge University Press, 2004).
[30] *Id.*
[31] *Id.*
[32] *Id.*
[33] *Id.* (in practice, however, the creditors normally undertake such investigations).
[34] Cohen, *supra* note 20, at 430.
[35] *Id.*

the debtor.[36] So, secured creditors can not use the contract theory in order to establish their rights against third parties.[37] Secondly, the availability of a secured transactions law is important to protect certain rights which cannot be left to the parties due to the inequalities in the bargaining powers.[38] Thirdly, without a law for secured transactions; secured finance agreements will be much more complicated.[39]

The availability of a secured transactions law in market-based economies is, therefore, necessary. Equally important, however, is the enforceability and certainty of the security interests created under any given secured transactions law. What is the advantage of taking security collateral if the creditor is not able to enforce it? To this end, a complementary law that go hand in hand with secured transactions laws is the availability of a well-developed insolvency law that deals with issues related to the insolvency of businesses including the status of the secured creditors on insolvency.

Given the benefits of security collateral, there seems to be an international consensus on the importance of security collateral and on the instrumental use of the law to facilitate secured finance.[40] Consider, for example, the European Bank for Reconstruction and Development (EBRD) and its role in promoting the reform of secured transactions laws in the transitional economies.[41] Other international organisations have stressed the importance and power of security such as the World

[36] *Id.*

[37] Cohen, *supra* note 20, at 430. Also, this is relevant in international financing; thus, choice of law is not much of help when the assets are located in a foreign jurisdiction. Foreign investors should take into consideration the secured transactions law in the foreign jurisdiction and not to rely on their agreements only. *See* Alejandro Garro, *Difficulties in Obtaining Secured Lending in Latin America: Why Law Reform Really Matters*, *in* EMERGING FINANCIAL MARKETS, *supra* note 3, at pp 251- 252

[38] Cohen, *supra* note 20, at 430

[39] *Id.* (argues that the availability of a secured transaction law is important to establish "default rules" – that is, the rules which govern issues not mentioned in the parties' agreement. If such law is not available the parties needs to draft their agreements in great detail which make such solution complicated and inefficient).

[40] MCCORMACK, *supra* note 29, at 18.

[41] *See, e.g.*, MODERN LAW ON SECURED TRANSACTIONS, THE EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT, (1994) [hereinafter MODERN LAW] *available at* http://www.ebrd.com.

Bank[42] and the United Nations Commission on International Trade Law (UNCITAL).[43] These international organisations have also developed model principles on insolvency laws to complement their work in the area of secured transactions.[44]

In sum, a secured transaction law, as part of an economic related law package, is necessary to facilitate and to encourage credit extension. However, the mere existence of a secured transactions law is not sufficient. Such law should meet the necessities of a market-based economy. To this effect, certain standards have developed and it is believed to constitute the basis for a good and sound secured transactions law. Prior to discussing the security laws in Saudi Arabia, it is important to review these growing principles and standards.

[42] *See, e.g.*, Heywood Fleisig, *The Power of Collateral,* PUBLIC POLICY FOR THE PRIVATE SECTOR (WORLD BANK), Note No. 43, (1995).

[43] *See, e.g.*, Spiros Bazinas, *UNCITRAL's Work in the Field of Secured Transactions, in* EMERGING FINANCIAL MARKETS, *supra* note 3, 211. Also, leading academics have stressed the importance of security law, *see, e.g.*, Roy Goode, *Security in Cross-Border Transactions,* 33 TEX. INT'L L. J. 47, (1998).

[44] This Chapter is mainly concerned with secured transactions laws. The author acknowledges, however, the importance of insolvency laws and it is essential complementary role in developing a secured transactions law in any emerging market. While this Chapter does not discuss either the international insolvency laws and standards or the Saudi insolvency laws in detail, insolvency laws are referred to where necessary. There are various initiatives in relation to insolvency laws that have developed as an important part of the market-based policies promulgated by the International Financial Institutions. *See generally* THE WORLD BANK, PRINCIPLES AND GUIDELINES FOR EFFECTIVE INSOLVENCY AND CREDITOR RIGHTS SYSTEMS, APRIL (2001) [hereinafter PRINCIPLES AND GUIDELINES FOR EFFECTIVE INSOLVENCY] *available at* http://www.worldbank.org. *See also* UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW, UNCITRAL MODEL LAW ON CROSS-BORDER INSOLVENCY, 30 MAY (1997) *available at* http://www.uncitral.org. *See also* UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW, UNCITRAL LEGISLATIVE GUIDE ON INSOLVENCY LAW, 25 JUNE (2004) *available at* http://www.uncitral.org. Also, the European Bank for Reconstruction and Development (EBRD) is supporting transition countries to revise their insolvency laws and implementing institutions. The EBRD has also developed the "Insolvency Law Assessment Project" to benchmark insolvency laws of the member states against the best international practices that incorporate the World Bank's PRINCIPLES AND GUIDELINES FOR EFFECTIVE INSOLVENCY referred to *supra. See generally* Nicolas Frome, *Multi-creditor Restructurings in Transition Countries: Lessons from Developed Jurisdictions,* LAW IN TRANSITION, (2000) *available at* http://www.ebrd.com. *See also* G22, *'Annex A: Key Principles and Features of Effective Insolvency Regimes', in* REPORT OF THE WORKING GROUP ON INTERNATIONAL FINANCIAL CRISES, (1998). *See also* Craig Averch, *Bankruptcy Laws: What is Fair?,* LAW IN TRANSITION, (2000) *available at* http://www.ebrd.com. *See also* Mahesh Uttamchanadni, *Insolvency Law and Practice in Europe's Transition Economies,* 10 JIBFL 452, (2004). For a good reference on English corporate insolvency law *see* ROY GOODE, PRINCIPLES OF CORPORATE INSOLVENCY LAW, (Sweet & Maxwell, 2005). *See generally* PHILIP WOOD, PRINCIPLES OF INTERNATIONAL INSOLVENCY LAW, (Sweet & Maxwell, 1995).

3. SECURED TRANSACTIONS LAW FOR A MARKET-BASED ECONOMY

3.1 THE DIFFERENT ATTITUDES TOWARDS SECURITY: AN OVERVIEW

The mere existence of a secured transactions law is not sufficient. Inefficient secured transactions laws constitute an obstacle to secured finance rather than playing a role in facilitating its functionality.[45] It is a truism, however, that different jurisdictions have developed different attitudes towards taking security collateral. These attitudes have been translated into different laws and rules. Such laws and rules have been influenced by different elements which include historical, economical, political and cultural dimensions.[46] Generally, these dimensions accumulate to form two main contexts; namely the pro-creditor and the pro-debtor contexts.[47] Generalisations can be made in order to place a particular legal jurisdiction under one of these contexts.[48]

However, there are two main families of law; namely, the civil law and the common law. In this Chapter, we are concerned with the context under which each family of law can be placed. Generally speaking, common law countries are considered to be very sympathetic to security and hence pro-creditor.[49] Civil law countries, on the other hand, are considered to be unsympathetic to security and hence pro-debtor.[50] Along the spectrum, other legal jurisdictions may fall in between both extremes.[51]

---

[45] Cuming, *supra* note 6, at 184.
[46] *See generally* Ross Cranston, *Credit Security and Debt Recovery: Law's Role in Reform in Asia and the Pacific*, *in* EMERGING FINANCIAL MARKETS, *supra* note 3, at 219.
[47] *Id.* at 222.
[48] *Id.* (however, Cranston argues that it is almost impossible to place a particular legal jurisdiction within any of both contexts).
[49] Wood, *supra* note 20, at 41(listing 84 very sympathetic jurisdictions including English law).
[50] *Id.* at 42.
[51] *Id.*

As mentioned earlier, various elements have played a role in shaping a particular legal jurisdiction as to security collateral laws. Thus, one of the main concepts that distinguish between civil law systems and common law systems is the doctrine of specificity.[52] This means that in civil law systems; security interests should be created over assets which are specifically identified. Thus, a civil law system recognises only the grant of security collateral to an identified, existing and specific asset, it does not recognise taking security over future assets for a pre-existing debt, and there is a reluctance to take security over future receivables.

On the other hand, common law systems have developed secured transactions laws which fairly accommodate modern secured finance techniques and hence; they provide a suitable legal background for countries adopting market-based economic policies.[53] The EBRD, however, has bridged the gap between both systems through the promulgation of the Model Law on Secured Transactions in 1994. The Model law provides that: "one principle which has guided the drafting of the Model has been to produce a text which is compatible with the civil law concepts which underlie many central and eastern European legal systems and, at the same time, to draw on common law systems which have developed useful solutions to accommodate modern financing techniques".[54] The next Section reviews the developed general standards for security interests which are believed to accommodate modern financing techniques.

However, as explained in Chapter One, the author's theme is based on "given assumptions". Thus, one of these assumptions is that a market-based economy requires a market-based legal infrastructure. Chapter One also explains that such

[52] PHILIP WOOD, COMPARATIVE LAW OF SECURITY AND GUARANTEES, at 5 (Sweet and Maxwell. 1995).
[53] *See* PREAMBLE, MODERN LAW, *supra* note 41.
[54] *Id.*

assumptions are based on the policies and views being propagated by the International Financial Institutions (IFI) and international economic organisations.[55] Developing security collateral laws is one example of these policies that are being propagated by the IFI. However, while there is no international consensus has evolved yet in respect of the secured transactions' underlying legal infrastructure; certain standards are emerging and international efforts in this area tend to support general standards as discussed in the next Section.

3.2 MODERN SECURED TRANSACTIONS LAW - THE GENERAL STANDARDS [56]

A modern practical legal framework governing security interests can be created using different approaches.[57] Choosing the approach is an issue which depends on the reformer and its existing secured transactions law if any. One approach is the 'minimalist' approach where amendment to the existing law by some fine-tuning and providing additional features is sufficient.[58] Another approach is to undertake an overall reform and modernisation of the existing secured transactions law in order to create a law that can play a facilitating role and not just a regulating one.[59] In reforming its secured transactions law, the reformer should take into consideration the developed international standards. Also, reforms should be in conformity with the general economic policies intended by the reformer.[60]

[55] *See generally* Chapter One.

[56] The following discussion of secured transactions is based on general standards that are based on certain policies being supported by the international financial community for the purposes of this thesis. This should not undermine other developed secured transactions laws in certain countries such as USA (*e.g.*, Article 9 of the US Uniform Commercial Code that governs secured transactions). A proponent of the US approach, for example, is Professor Sir Roy Goode. *See* Roy Goode, *The Exodus of the Floating Charge, in* CORPORATE AND COMMERCIAL LAW: MODERN DEVELOPMENTS, at 202-3 (David Feldman et. al., eds., Lloyds of London Press Ltd, 1996). For a thorough comparative study between the US and English secured transactions law; *see generally* MCCORMACK, *supra* note 29.

[57] Cuming, *supra* note 6, at 191.

[58] *Id.*

[59] *Id.*

[60] As the law is the instrument which is used to achieve the economic polices of any state; the law governing security interests should act as facilitator for emerging markets to make the achievement of market economy more efficient.

Several issues should be taken into account by the reformer that undertakes to modernise its secured transactions law. Firstly, because the main purpose of taking security collateral is to reduce the creditors' credit risk; secured transactions laws should allow the creation of security interests that achieves such purpose. To this effect, the law should allow the use of security in the "widest possible range of circumstances".[61] Secondly, the law should not undermine the views of both parties (*i.e.,* the creditor and the debtor). Thus, creditors should feel that the assets are secure and debtors should have the right to retain the secured assets in order to keep the business running and to enable them to repay the principal and the debt service.[62] Thirdly, the law should address the extent of the party autonomy allowed between the parties.[63]

Having said that, a sound secured transactions law should be guided by general principles to improve the efficiency of the system and the availability of credit. These principles have two dimensions: structural and substantive. From a structural viewpoint, the legal framework for secured transactions should address various issues including the creation of security interests, the perfection of security interests, the priorities among secured creditors and the enforcement of security interests. Under each of the above-mentioned structural elements, substantive rules could be developed to accommodate modern financing techniques.

3.2.1 CREATION OF SECURITY INTERESTS

Rules related to the creation of security interests are those rules which deal with the formalities required to create a security collateral, the nature of assets given as a

[61] Simpson et al., *supra* note 3, at 144.
[62] *Id.* at 155. However, the law should address the competing interests of the various creditors (*i.e.*, secured and unsecured creditors); *see* Thomas Laryea, *Development of Standards for Security Interests*, (IMF Legal Department, 2003) *available at* http://www.imf.org.
[63] Laryea, *supra* note 62, at 2.

security, the nature of the secured debts, the security giver, the security receiver and the use of the secured assets. A sound secured transactions law should establish simple and cost-effective rules for the creation of security interests.[64] Excessive formalities lead to their circumvention and undermining the predictability of the secured transactions law.[65] This means that formalities, taxes and duties must be kept to minimum. More important is the nature of assets that are being given as security collateral. The traditional use of security has always been confined to non-possessory security interest over immovables and possessory security interests over movables.[66] Modern financing techniques, however, require that security be given over all types of assets.

The creation of security interests over all types of assets means that it is not confined to immovables only but encompasses movables and rights.[67] Thus, the law should allow non-possessory security interests over movables to be created. Such has proved to encourage and to attract foreign investments.[68] Likewise, security in rights plays a very important role in modern financing. For example, security in rights plays an important role in project financing where the reliance is on the receivables generated by the project being financed.[69] The lenders would ensure to take security over these receivables. The availability of such form of security is helpful for emerging markets that are desirous to attract credit and project financing to meet their developmental demands.

---

[64] Simpson et al., *supra* note 3, at 148.
[65] Laryea, *supra* note 62, at 4.
[66] *Id.*
[67] Simpson et al., *supra* note 3, at 151.
[68] Laryea, *supra* note 62, at 4.
[69] Simpson et al., *supra* note 3, at 151.

The law should allow for the creation of security interests over future or after-acquired assets.[70] Some jurisdictions impose restrictions to that effect being influenced by the concept of specificity mentioned above.[71] The implementation of this concept dictates that no security interests can be created over any kind of assets unless such assets are specifically identified. Such principle is problematic for modern financing where creditors look for future assets as well as existing assets. In addition, the law should allow for the creation of security interests over "changing pool of assets" and the parties should be allowed to describe the assets generally.[72] Allowing the creation of security interests over "changing pool of assets" encourage financing techniques such as receivables and inventory financing. Again, the concept of specificity is in direct contradiction with such principle.

Furthermore, the law should allow giving security collateral for existing as well as future debts.[73] However, the secured debt should not be confined to a static debt only.[74] Taking security over a "changing pool of debt" should be allowed.[75] Such facilitates taking security over overdraft facilities or revolving credits.[76] Therefore, parties should be allowed to describe the secured debt generally by "reference to a general class description".[77] In addition, the law should address the nature of the parties involved (*i.e.,* creditors and debtors). Thus, the law should allow any security-giver and any security-receiver to give or receive the security.[78]

[70] Simpson et al., *supra* note 3, at 151.
[71] *See* the discussion *supra.*
[72] Simpson et al., *supra* note 3, at 151.
[73] *Id.* at 150 (defines future debts as "debts which are created or become owed by the debtor after the creation of the security right").
[74] *Id.* at 151.
[75] *Id.*
[76] *Id.*
[77] *Id.*
[78] *Id.* at 149-150.

Finally, the law should allow the use of the secured assets by the debtor who gave the security.[79] For the debtor to maintain the full economic advantage of the assets; it is desired that the debtor possesses the secured assets and make use of them. Thus, if the debtor purchases certain machines on credit; it is desirable that the debtor remains in the possession of the machines in order to make use of them and produces the intended product.[80] In this sense, the debtor would be able to repay the principal and the debt service. This does not mean, however, that possessory security collateral should be abolished. Possession in certain secured transactions might be more desirable to creditors.[81]

3.2.2 PERFECTION, PRIORITIES, AND ENFORCEMENT OF SECURITY INTERESTS

Having explained the general principles for the creation of security interests; it is essential to mention other important elements of a sound secured transactions law such as the perfection and enforcement of security interests. Perfection of security interests is basically the public demonstration of their existence and the establishment of their priority. Perfection is of great importance to secured creditors to protect their rights *vis-à-vis* third parties. Because giving security might affect third parties, a sound secured transactions law should create a mechanism whereby third parties can be notified of the security in question. The traditional demonstration of possessory security interests is normally accomplished through the possession of the secured assets itself. In modern financing, however, non-possessory security interests have been allowed in certain jurisdictions. Hence, possession of the secured assets no longer serves the purpose for the demonstration of the security interest. Another mechanism has been developed; that is, a public registry.

[79] *Id.* at 153.
[80] *Id.*
[81] *Id.* at 154 (explaining that when giving security collateral over gold bars or negotiable instruments; traditional possessory security collateral is more desirable).

The whole purpose of this new registration mechanism is to restrict the presentation of false wealth. Such is important for third parties in order to avoid any false appearance of the debtor's wealth.[82] Hence, transparent and clear perfection rules are crucial for a sound secured transactions law.[83] Equally, priority rules should be clear, certain, transparent and predictable.[84] The security holder should be 'super-priority creditor'.[85] Such principle should continue even through insolvency.[86]

Finally, enforcement and realisation of the security procedures should be effective as well as cost and time efficient.[87] Such is of great importance because creditors rely mainly on the secured assets for recovery and repayment. The secured assets would be more valuable for the creditors if their enforcement is of a short space of time.[88] Certain rules could hinder the realisation of the security or delay its enforcement. For example, remedies might confine realisation of the security to public auctions rather than the availability of a private sale. Also, other restrictions such as compulsory grace periods on the enforcement of the right may delay the realisation process.[89] Any delay of the realisation of the security is in turn a delay for the recovery of payment. Such factor influences the creditors' judgement when extending credit to the borrower.

In sum, a sound secured transactions law which accommodates modern financing techniques should be transparent, predictable and coherent. Certainty of the secured

[82] *See* WOOD, *supra* note 52, at 4-5 (discussing the concept of false wealth).
[83] Laryea, *supra* note 62, at 3.
[84] *Id.*
[85] WOOD, *supra* note 52, at 3.
[86] *Id.* However, the priority of the secured creditor issue has attracted academic debate. *See generally* Thomas Jackson et. al., *Secured Financing and Priorities Among Creditors,* 88 YALE L. J 1143, (1979); Alan Schwartz, *A Theory of Loan Priorities,* 18 J. LEGAL STUD 209, (1989); Riz Mokal, *Priority as Pathology: The Pari Passu Myth,* 60 CLJ 581, (2001); Riz Mokal, *The Search for Someone to Save: A Defensive Case for the Priority of Secured Credit,* 22 OJLS 687, (2002).
[87] As pointed out earlier, here a well-developed insolvency and bankruptcy laws are of great importance.
[88] Simpson et al., *supra* note 3, at 147.
[89] *See generally* WOOD, *supra* note 52, 137 – 147.

transaction law is one of its essential elements. This means that secured creditors should be certain as to their priority over the secured assets,[90] when the security can be realised,[91] when the security right existed[92] and whether the creditors are able to restrict redemption of the security collateral.[93] Equally important is that such security right must be a right *in rem* capable of being enforced against third parties.[94] Having summarised the general principles of a sound secured transactions law; it is helpful to discuss in the following section the use of collective security arrangements in financing transactions and its importance.

3.2.3 THE USE OF COLLECTIVE SECURITY ARRANGEMENTS IN FINANCING TRANSACTIONS

A collective security arrangement is defined as "an arrangement whereby security is held for the common benefit of a number of lenders".[95] Perhaps one of the most well-known concepts that are used in collective security arrangements is the use of trusts. In modern financing transactions, trusts play a very important role.[96] In syndicated loans and project finance transactions; security trustees play an important role for different reasons including: 1) to facilitate the trading of loans among lenders;[97] and 2) to remove the insolvency risk of an agent or other third party holding the security on behalf of the lenders.[98] Given its benefits, many jurisdictions have introduced the trust concept into its legal systems in order to facilitate financial-

[90] Simpson et al., *supra* note 3, at 147.
[91] *Id.*
[92] *Id.*
[93] WOOD, *supra* note 52, at
[94] Simpson et al., *supra* note 3, at 146.
[95] THIELE, *supra* note 15, at 1.
[96] *See generally* Christopher Duffet, *Using Trusts in International Finance and Commercial Transactions,* 1 J. INT'L. PLAN. 23, (1992).
[97] Neil Cuthbert, *'Security for Projects: Part 3',* 17(1) INTBFL 4, at 6, (1998).
[98] *Id.*

related transactions. Most recently, a member of the G.C.C, namely; the Kingdom of Bahrain has introduced a trust law to facilitate financial transactions.[99]

In jurisdictions where the concept of trust is not recognised; collective security arrangements have been structured using alternative devices. Agency and other concepts[100] have been used as an alternative to the trust in collective security arrangements. Such structures do not normally achieve the same purpose achieved when using the trust in collective security arrangements. However, seven practical requirements are argued to constitute necessary elements for any good collective security arrangement structure; these are:[101]

1) it should be possible to create security without having to name or register the individual lenders that are to benefit from the security;
2) it should be possible to put one person in charge of monitoring and enforcing the security, subject to terms that are agreed in advance;
3) lenders' rights in respect of the security and proceeds of the security must be properly protected;
4) lenders' rights in respect of the security must be transferable;
5) security should be capable of covering new loans, even if they are made by new lenders;
6) it should be possible to replace the person in charge of the security without affecting the security; and
7) the arrangement should be simple and straightforward as possible.

A sound market-based legal infrastructure secured transactions law should allow these practical requirements to be implemented in order to be able to transact

[99] *See* LAW NO. (23) OF THE YEAR 2006 REGARDING THE REGULATION OF FINANCIAL TRUSTS *available at* http://www.bma.gov.bh.
[100] *Rahn Adl* has been used as a collective security arrangement in Saudi Arabia, *see* discussion *infra*.
[101] THIELE, *supra* note 15, at 19-25.

collective security arrangements structures in financial transactions in an effective manner.

4. SECURED TRANSACTIONS LAW IN SAUDI ARABIA

Studying the laws related to security interests in Saudi Arabia is one of the areas that highlight the tension arising from the *existing de facto duality*. It is an area where there is an interaction between the Saudi conventional finance component and the overall legal system of Islamic *Shari'a*. Arguably, a strong market-led financial system requires a sound secured transactions law based on the general principles discussed above. In Saudi Arabia, however, the conventional finance component of the Saudi financial system is functioning within a legal system which does not, to a certain extent, absorb its practices. The "Islamic finance" component, on the other hand, lacks a definitive legal framework and hence, although it does provide a major financing option that may not require a secured transactions law based on the above discussed standards; its legal foundations need further enhancement as will be discussed later.

In Chapter Two, the author has already highlighted and discussed the *existing de facto duality* in Saudi Arabia, its implications and the emerging "Islamic finance" component. This Section further focuses on a very important area for the Saudi emerging financial markets which is secured transactions. In the area of secured transactions, the Saudi conventional finance component is faced with security collateral rules which might not, to a certain extent, facilitate its financing practices. The Saudi financial system is, therefore, constrained and may not function in its full capacity.

Thus, obstacles arise when international lenders are invited to finance projects in Saudi Arabia. Lenders, whether domestic or international, would require a good security collateral package. Such may not be available under the Saudi secured transactions law. For example, in one of the largest project finance transactions in Saudi Arabia; lenders had to accept a very limited security package due to the considerable difficulties associated with the secured transactions law.[102] Consequently, lending practices in Saudi Arabia have been transacted with the reliance on third-parties guarantees.[103] The reliance on guarantees is a natural reaction to the difficulties associated with taking security interests that do not meet the lenders' expectations and do not accommodate modern financing techniques.[104]

Another obstacle facing the financial system in Saudi Arabia is the difficulty to notarise the security collateral.[105] A circular has been issued by the Ministry of Justice preventing notaries to notarise any security collateral to commercial banks on the ground that such banks are dealing with interest and practicing in a manner which is inconsistent with the principles of the Islamic *Shari'a*.[106] This highlights the tension arising from the *existing de facto duality*. Commercial conventional banks, however, have devised other *means* to notarise security interests and to circumvent any restrictions.

[102] John Dewar, *Yanpet: Largest Petrochemical Plant Financing*, April IFLR 7, at 8, (1998). *See also* Philip Fletcher et al., *The Yanpet Recipe*, *in* PFI YEARBOOK, 124 (IRF, 1998).

[103] Michael McMillen, *Islamic Shari'ah-Compliant Project Finance: Collateral Security and Financing Structure Case Studies*, 24 FORDHAM INT'L L J. 1184, at 1206, (2001).

[104] Laryea, *supra* note 62, at 5 n. 4 (arguing that the reliance on guarantees is also resulting from the availability of inflexible non-possessory security laws. Such is argued to be problematic to small as well as medium size enterprises because they may not have third party guarantees. It is also problematic for larger corporations because such guarantees are normally required from shareholders; thus; undermining the limited liability of the shareholder in case of insolvency).

[105] In Saudi Arabia, recordation of real property is effected by the Public Notaries.

[106] *See* Supreme Judiciary Council Circular, No. 291, dated (25/8/1981).

Instead, Saudi conventional banks notarise the security interests in the name of a trusted person, normally a bank manager.[107] In doing so, the security interest is considered to be given to a person rather than a bank. The bank guarantees its rights by concluding an agreement with that person providing that the security interest is in fact for the benefit of the bank. Such solution, however, is impractical, complicated and risky. Thus, that person might be dishonest and claim his right in the secured assets or his estate might claim it in case of death. There is no doubt that a well-developed financial system cannot function on the basis of such practice. Such practices need to be measured against their adverse affect in hindering access to credit and in reducing the predictability and the transparency of the legal system.

However, such procedural problems might be solved in the light of the current reforms being undertaken by the Saudi government. In the meantime, law firms through their "legal work"[108] have developed security structures in order to facilitate financing transactions in Saudi Arabia. Also, the "Islamic finance" component in Saudi Arabia has provided an alternative option for financing that may not face such procedural obstacles.[109] Thus, it can be argued that the growing "Islamic finance" practice in Saudi Arabia is not attributed to the prohibition of interest only but also because "Islamic finance" legal structures are in line with the overall legal system of Saudi Arabia, that is, Islamic *Shari'a*.

However, the recent enactment of the new security collateral law over movables in Saudi Arabia highlights the government's awareness of the importance of secured transactions laws. Whether such law has fulfilled the desired objective in constituting

[107] Such practice has been confirmed by legal practitioners. *See also* McMillen, *supra* note 103, at 1223, n. 58.
[108] *See* the definition of "legal work" McBarnet, *supra* note 14.
[109] *See* discussion *infra*.

a sound secured transactions law to accommodate modern financing techniques is a matter which will be discussed later in this Chapter.

4.1 SECURITY LAW BEFORE 2003: AN OVERVIEW

Prior to 2003 there was no specific statute on secured transactions in Saudi Arabia.[110] Therefore, the general law governing security interests is the Islamic *Shari'a*. Under Islamic *Shari'a*, the *rahn* is the main security interest which can be taken over assets.[111] *Rahn* applies to both movable as well as immovable assets.[112] Hence, *rahn* can neither be translated as a 'pledge' nor as a 'mortgage'.[113] Nevertheless, the translated version of the *Majalla*[114] defines *rahn* as "a pledge consists of setting aside property from which it is possible to obtain payment or satisfaction of some claim. Such property is then said to be pledged, or given in pledge".[115] *Rahn* is classified as a contract[116] based on four elements[117] related to the: 1) contracting parties, 2) the secured asset, 3) the secured debt[118] and 4) the formulation of the contract.[119] These are the four elements of the *rahn* contract.[120]

[110] McMillen, *supra* note 103, at 1194.
[111] Nick Foster, *The Islamic Law of Real Security*, 15(2) ALQ 130, at 134, (2000).
[112] *Id.* at 134 -135.
[113] Under English law the pledge applies over movables only while the mortgage applies over immovables. Hence, the word *'rahn'* will be used in this volume. On English security collateral law *see generally* ROY GOODE, COMMERCIAL LAW, (Lexis Nexis UK, 2004).
[114] References to the *Majalla* in this Chapter are based on *Majalat Al-Ahkam Al-Adliyah* unless indicated otherwise. *See* Chapter One on the *Majalla*.
[115] THE CIVIL LAW OF PALESTINE AND TRANS-JORDAN (Volume 1), art. 701, at 171 [hereinafter THE CIVIL LAW OF PALESTINE] (C. A. Hooper trans., Azriel Printing Works, 1933) (which is a translation of *Majalat Al-Ahkam Al-Adliyah*). However, as explained, the translation of *rahn* is not accurate.
[116] Foster, *supra* note 111, at 135.
[117] An "element" of a contract is the translation for the word "*rukn*". The absence of a *rukn* renders the contract void. Unlike other Islamic Schools, the *Hanafi* School recognises one *rukn* (*i.e.,* element) for the *rahn* contract which is the offer and acceptance.
[118] The term 'secured debt' is not totally accurate under certain Islamic Schools which recognise that a secured asset can be given as a security against a physical asset *'ayn*. *See* the definition of *'ayn infra*.
[119] M. Abu Al-Rish, *Bayan Madhahib Al-Fuqaha Fi 'Aqd Al-Rahn*, at 61 (Matba'at Al-Amanah, 1986). *See also* A. Barshumi, *Al-Rahn Wa Al-Shuf'ah Fi Al-Fiqh Al-Islami*, at 38 (Dar Al-Taba'ah Al-Muhmmadiyah, 1988).
[120] The term "fundamental basis" is used in the translated version of *Majalat Al-Ahkam Al-Adliyah*. *See* Hooper; THE CIVIL LAW OF PALESTINE, *supra* note 115 (referring to the element of the *rahn* contract as "fundamental basis"). *See* Abu Al-Rish and Barshumi, *supra* note 119.

The contracting parties include both the security grantor (*i.e.*, the debtor)[121] and the security grantee (*i.e.*, the creditor).[122] Both should have the capacity by being sound minded.[123] In addition, the secured assets are considered valid and can be subject to the *rahn* under Islamic *Shari'a* if certain requirements are met. First, the secured asset should be *'ayn*[124] which is "a specific existing thing, considered as a unique object and not merely as a member of a category".[125] Second, the secured asset should be something which "may be validly sold".[126] This means that the secured asset should be in "existence at the time of the contract, must have some specific value and be capable of transfer".[127] Thus, four conditions must be satisfied in any asset in order to be given as a *rahn*; these are:[128] legality,[129] existence, deliverability of the asset and its precise determination. Therefore, future assets can not be granted as a security.[130] Thirdly, the secured asset should be one that can be

[121] The person who gives the *rahn* is called '*rahin*'. *See*, THE MEJELLE BEING AN ENGLISH TRANSLATION OF MAJALLAHEL-AHKAM-I-ADLIYA AND A COMPLETE CODE ON ISLAMIC CIVIL LAW, art. 703 [hereinafter THE MEJELLE] (Tyser et al. trans., Law Publishing Company, 1901; reprint 1967) (which is another translated version of *Majalat Al-Ahkam Al-Adliyah*).
[122] The person who takes the *rahn* (*i.e.*, security grantee) is called '*murtehin*'; THE MEJELLE, *supra* note 121, art. 704
[123] THE CIVIL LAW OF PALESTINE, *supra* note 115, art. 708,
[124] Abu Al-Rish, *supra* note 119, at 77. However one of the Islamic Schools; namely, the *Maliki* School does not require the secured asset to be *'ayn.*
[125] FRANK VOGEL ET. AL , ISLAMIC LAW AND FINANCE: RELIGION, RISK, AND RETURN, at 94 (Kluwer Law International, 1998). *See also* Chapter Four, Section 4.3.1 on the difference between *'ayn* and *dayn*.
[126] THE CIVIL LAW OF PALESTINE, *supra* note 115, art. 709 at 172
[127] *Id.*
[128] SUSAN RAYNER, THE THEORY OF CONTRACTS IN ISLAMIC LAW, at 131 (Graham & Tortman, 1991).
[129] *Id.* (legality means that the object "must be legal..., in that it is beneficial, that it is a commodity capable of being traded in (*mal mutaqawwim*), that its subject matter ...and underlying cause ...are lawful, and that it is not proscribed by Islamic law, public order or morals") . *See also*, THE MEJELLE, *supra* note 115, art. 127 (explains *mal mutaqawwim* referred to in the definition of legality as being "used in two senses: one is a thing the benefit of which is permissible by law to enjoy. The other means property ...acquired. For example - A fish in the sea is not *mal mutaqawwim*, when it is caught and taken it is *mal mutaqawwim*").
[130] Foster, *supra* note 111, at 140. However, certain exceptions apply to this general rule; for example, assets can be added to the *rahn* after the formation of the *rahn* contract, *see* art. 713, THE CIVIL LAW OF PALESTINE, *supra* note 115, at 173. However, under this exception future assets can not be covered as they need to be specifically added afterwards; *see* Foster, *supra* note 111, at 140.

possessed.[131] If the secured asset can not be possessed, such asset does not qualify as an asset that can be secured under Islamic *Shari'a.*[132]

The third element of the *rahn* contract is the secured debt. Secured debts refer to the obligations that can be secured. Such should be in existence and certain.[133] Thus, security over future debts is not allowed.[134] The forth element of the *rahn* contract is the formulation of the contract itself. The contract is normally concluded by the offer and acceptance.[135] Such could be either in oral or in writing[136] whether expressly or impliedly.[137] These elements of the *rahn* contract are essential because the absence of any of these elements renders the *rahn* contract null and void.[138] A void *rahn* contract would mean that the contract has no effect and is legally non-existent.[139]

In addition, *rahn* is a possessory security interest and the transfer of possession is essential. Article 706 of the *Majalla* states that "...if the [*rahn*] is not transferred to the effective possession of the [security grantee], however, such contract is incomplete and revocable. The [security grantor] may, therefore denounce such contract before delivery of the [*rahn*]".[140] A question arises here as to the classification of the possession in the *rahn* contract under Islamic *Shari'a,* that is, if possession is one of the main elements of the contract or it is only a condition.

131 Abu Al-Rish, *supra* note 119, at 80.
132 *Id.*
133 Nick Foster, *Commercial Security over Movables in the UAE: A Comparative Analysis in the Light of English Law, French Law and the Shari'a,* 4 YEARBOOK ISLAMIC & MIDDLE EASTERN L. 3, at 21 (1997-1998).
134 *Id.*
135, THE CIVIL LAW OF PALESTINE, *supra* note 115, art. 706at 171
136 Barshumi, *supra* note 119, at 48-49.
137 *See, e.g.,* THE CIVIL LAW OF PALESTINE, *supra* note 115, art. 707, at 171.
138 RAYNER, *supra* note 128, at 150: "*Batil* [Null and void] is when the pillars of the contract are breached, or when its cause is imperfect".
139 *Id.* at 168.
140 THE CIVIL LAW OF PALESTINE, *supra* note 115, art. 706, at 171. A Similar provision is found in *Majalat Al-Ahkam Al-Shri'yah. See* AHMAD AL-QARI, *MAJALAT AL-AHKAM AL-SHRI'YAH,* art 996 [hereinafter *AL-SHRI'YAH*] (Tihama Publications, 1981).

Foster argues that possession of the assets is a "fundamental basis" under the *rahn* contract.[141] The "fundamental basis" quoted by Foster is the terminology which is used in the translated version of the *Majalla* for the word *rukn* in Arabic (*i.e.*, an element of a contract).[142] He mentions, critically, that the *Majalla* has failed to indicate to this "fundamental basis" in its definition of *rahn* and in its classification of *rahn* as a contract.[143] To justify his argument, Foster particularly refers to Article 729[144] of the *Majalla* which provides that it is "a *fundamental rule* that the [grantee] has the right of retaining possession of the [*rahn*] until the redemption thereof".[145]

However, contrary to Foster's argument, possession of the secured assets under the *rahn* contract is not considered one of its "fundamental basis". Two reasons constitute the basis for this counter-argument. Firstly, confusion in this regards arise provided by the translated version of the *Majalla* relied upon by Foster.[146] The terms "fundamental basis" and "fundamental rule" have been used as one translation for two different words in Arabic; it can hardly be seen that such translation give an accurate translation for both Arabic words.

The term "fundamental basis" used in the *Majalla* in the Heading to Section 1, Chapter 1 of Book V (HSCB) was the translation for the Arabic word *rukn*.[147] Such can be translated as the pillar/element of the contract. For example, under English contract law 'consideration' is one of the main pillars/elements of the contract; and hence, it is a *rukn*. As will be seen, classifying whether a specific action is a *rukn*

[141] Foster, *supra* note 111, at 136.
[142] That is, the translated version of the *Majalla* by Hooper, *see* THE CIVIL LAW OF PALESTINE, *supra* note 115 (*see* the Heading to Section 1, Chapter 1 of Book V of the *Majalla* is entitled "Fundamental Basis of the Contract of [*rahn*]".
[143] Foster, *supra* note 111, at 136.
[144] Foster, *supra* note 111, at 136 n. 25.
[145] THE CIVIL LAW OF PALESTINE, *supra* note 115, art. 729, at 176.
[146] That is, the translated version of the *Majalla* by Hooper, *see* THE CIVIL LAW OF PALESTINE, *supra* note 115.
[147] *See* the Heading to Section 1, Chapter 1 of Book V of the Arabic version of the *Majalla* by SALIM RUSTAM, *Sharh Al-Majalla,* at 385 (Matba'a Al-Adabiya, 1923).

(pillar/element) of the contract or not is one of importance. On the other hand, the term "fundamental rule" used in Article 729, which is relied upon by Foster to justify his argument, was the translation for a completely another word and gives a different meaning as opposed to the word used in HSCB. In the Arabic version of article 729 there is no mention of the term "fundamental rule". Another translated version offers somewhat better translation of Article 729 which states: "a consequence of making [*rahn*] is that the [security grantee] has a right to keep possession until redemption...".[148] Thus, it is a "consequence" and not a "fundamental rule". So, literally it can not be relied upon Article 729 to justify that possession is a "fundamental basis".

Reverting to the term "fundamental basis" used in the HSCB; and according to the Arabic version, the term is a translation for the word *rukn* in the singular (*i.e.*, one element). Under the HSCB there is no explicit mention that "possession" is a *rukn*/element, or in the words of Foster "fundamental basis", of the contract. Even Foster has pointed this critically as explained above. This leads us to the second reason for our counter-argument. The reason is because if the secured assets under the *rahn* contract are not transferred to the effective possession of the creditor; the contract is not *null and void* but it is *revocable*.[149]

Legally, as mentioned above, the absence of the contract's *rukn*/element renders the contract *null and void*. In the *rahn* contract it is clear from Article 706 mentioned above that the absence of "possession" does not render the *rahn* contract *null and void* but *revocable*. Hence we reach the conclusion that the possession of the secured assets under the *rahn* contract is not a "fundamental basis", element, pillar or *rukn* of

[148] THE MEJELLE, *supra* note 121, art. 729.
[149] THE CIVIL LAW OF PALESTINE, *supra* note 115, art. 706 at 171.

the contract. In fact, there is a consensus among the four Islamic Schools that possession is not a *rukn* but it is a condition.[150]

Nevertheless, the possession of the *rahn* is a must in order for the security interest to be perfected against third party creditors.[151] If the creditor fails to take possession of the secured asset; such creditor is treated on *pari passu* basis with other creditors. Thus, the creditor should have possession of the secured asset in order to secure a super-priority status *vis-à-vis* other creditors. The position in Saudi Arabia tends to require the actual physical possession of the secured assets.[152] However, the possession of real property in Saudi Arabia has been deemed to be a type of "constructive possession" of the secured asset.[153] This normally is effected by concluding a *rahn* agreement and recording the security interest on the title deed to evidence the security interest.[154] Creditors have the right to enforce the security on non-payment of the debt. Such can be done through a judicially directed sale of the secured assets.[155]

4.2 SECURITY LAW POST-2003: THE COMMERCIAL *RAHN* LAW

Amidst the current legal reforms in Saudi Arabia; the government has enacted a new security collateral law. This law confirms the government's desire to facilitate adopting a market based legal infrastructure. The Commercial *Rahn* Law of 2003 (CRL)[156] deals with movable assets only. CRL provides that a commercial *rahn* is a *rahn* over a movable securing a *commercial* debt.[157] A debt is 'commercial' when is considered so by the debtor as well as all the other involved parties whose rights and

[150] Abu Al-Rish, *supra* note 119, at 47-50 & 112-113.
[151] McMillen, *supra* note 103, at 1221.
[152] *Id.*
[153] *Id.* at 1222.
[154] *Id.*
[155] THE CIVIL LAW OF PALESTINE, *supra* note 115, art. 757 at 181.
[156] *See Rahn* Law, *supra* note 19.
[157] *Rahn* Law, *supra* note 19, art. 1.

obligations are related to that *rahn*.[158] Introducing the commercial *rahn* through the CRL has certain implications. First, a clear distinction is made between commercial and non-commercial (*i.e.,* civil) *rahn*. So, the CRL governs security over movables in commercial transactions while Islamic *Shari'a* governs security over movables in non-commercial transactions. Second, the CRL governs movable assets only which means that immovables are still governed by the Islamic *Shari'a* whether for commercial or non-commercial transactions. The CRL applies to both tangible and intangible movables.[159] Intangible assets covered by the CRL include but not limited to negotiable instruments,[160] bearer instruments,[161] and nominative instruments.[162] Other intangible assets, however, such as securities, intellectual property, patents and trademarks are excluded from the CRL.

Assets which can be secured under the CRL should be one that can be sold and can be precisely specified in the *rahn* contract or in a later one.[163] However, giving security over future assets is not allowed under the CRL.[164] The *rahn* should secure an existing debt which should be stipulated in the *rahn* contract.[165] The security grantor could be the debtor himself or anyone providing a security on his behalf and in his favour.[166] At any case, the security grantor should be the owner of the assets

[158] *Id.* However, it is not very clear whether a debt is commercial when it is considered so by the debtor only or by all the parties. *See, e.g.,* art. 2(b), Implementation Rules of the *Rahn* Law, Ministerial Decision No. 6320, (18/6/1425 H) [hereinafter Implementation Rules] *available at* http://www.moc.gov.sa (provides that in order for the *rahn* contract to be governed by the *Rahn* Law; such *rahn* should secure a debt which is commercial to the debtor. No mention in the Implementation Rules to any other parties).
[159] Implementation Rules, *supra* note 158, art. 2(a).
[160] *Id.* arts 1& 13 (negotiable instruments such as cheques and bills of exchange).
[161] *Id.* art. 1(f) (bearer instruments are defined as commercial instruments not bearing the beneficiary's name)
[162] *Id.* art. 1(e) (nominative instruments are defined as shares, bonds and other securities bearing the name of their owner).
[163] *Rahn* Law, *supra* note 19, art.2.
[164] *Id.*
[165] *Id.* art. 3.
[166] *Id.* art. 4.

given as security.[167] If the security grantor is not the owner of the secured assets; the creditor has the right to demand an alternative security asset or revoke the contract.[168]

The security interests can only be perfected *vis-à-vis* third parties by transferring the possession of the secured assets to the creditor or to an *adl*[169] designated by the contracting parties.[170] The secured assets should always remain in the possession of the creditor or the *adl*.[171] The creditor/*adl* is considered to be in the possession of the secured asset when it is placed at his disposal in a manner leading others to believe that the secured asset has come under his possession.[172] However, the creditor can be considered in possession of the secured assets if he receives a document (*suk*) which grants him only and not others the right to receive the secured asset.[173] In case the secured asset is an instrument;[174] possession is effective when such instrument is transferred to the possession of the creditor.[175] If such instrument is deposited with third parties; transfer of possession is effective upon the transfer of the deposit receipt.[176] Hence, the CRL does not allow for non-possessory security interests over movables.

The law sets out certain procedures and conditions regarding instruments which must be fulfilled when concluding a *rahn* transaction. In case of nominative instruments, the *rahn* contract should be in writing, the *rahn* should be evidenced in

---

167 *Id.*
168 *Id.*
169 An *adl* is a trusted third party who can hold the security on behalf of the parties. *See* the discussion of the *adl infra.*
170 *Rahn* Law, *supra* note 19, art. 6
171 *Id.*
172 *Rahn* Law, *supra* note 19, art. 7. *See also* Implementation Rules, *supra* note 158, art. 16(a)
173 *Rahn* Law, *supra* note 19, art. 7. *See also* Implementation Rules, *supra* note 158, art. 16(b),
174 That is negotiable instruments, bearer instruments and nominative instruments covered under the *Rahn* Law.
175, *Rahn* Law, *supra* note 19, art. 8. *See also*, Implementation Rules, *supra* note 158, art. 17
176 *Id.*

the records of the issuer and on the instrument itself.[177] Negotiable instruments can be given as a security by endorsing the instrument provided that the endorser is the legal holder of the instrument and that the endorsement is in writing on the instrument itself stating, for example, that the instrument's amount is for *rahn*.[178] Finally, providing bearer instruments as security should be in writing and the issuer of these instruments should be notified.[179] Generally, however, all the competent entities involved in issuing instruments should create record to evidence all the details relevant to each instrument including the name of the security grantor, the name of security grantee, amount of the secured debt, date of the *rahn* contract and name of the *adl* if any.[180]

The debtor is entitled to satisfy the debt on the due date. In case of the debtor's failure, the creditor has the right, after three working days of the due date, to file for the sale of all or part of the secured assets.[181] The CRL imposes a five-day period before the enforcement. Thus, the sale of the secured assets is only allowed five days after notifying the debtor and his guarantor if any.[182] The place of the sale, its date and the time must also be notified.[183] If there is more than one asset securing the debt; the creditor has the right, unless otherwise agreed, to designate the asset upon which the sale should take effect.[184] Unless the court designates another *means* of

[177]Implementation Rules, *supra* note 158, art. 12
[178] *Id.* art. 13.
[179] *Id.* art. 14.
[180] Implementation Rules, *supra* note 158, art. 6. *See also* art. 7 allows for such information to be evidenced through a computer system with certain conditions.
[181] *Rahn* Law, *supra* note 19, art. 15,
[182] *Id*, art. 16
[183] *Id.*
[184] *Id.*

sale, it should be through public auction.[185] The time and the place of the sale are also designated by the court.[186]

However, if the secured asset is a commercial instrument; permission from the court for the transfer of title endorsement must be sought.[187] If the market value of the secured asset depreciates and does not cover the secured debt; the creditor is entitled to claim the difference from the debtor.[188] The CRL does not allow the parties to contract out from the enforcement measures provided by the law.[189] The parties, therefore, can not stipulate in the contract different conditions regarding the sale of the secured assets or the transfer of title to the creditor upon default.[190]

4.3 SAUDI LAW AND THE ESSENTIALS OF A MODERN LAW FOR SECURED TRANSACTIONS[191]

It can be fairly argued that the development of secured transactions laws is influenced by the development of the financial markets. In developed market economies where financial systems play a pivotal role in the economy; the scope of security collateral has been expanded and developed in order to accommodate and to meet the needs of the financial system. Saudi Arabia, however, is a new emerging market country and its financial system is constrained by Islamic legal prohibitions such as *riba* and *gharar*.[192] Nevertheless, Saudi Arabia is desirous to adapt to market economies, to accommodate modern financing techniques and to create a market-friendly legal framework. This is reflected by the various newly promulgated laws including the CRL discussed above.

[185] *Id.* art. 17.
[186] *Id.*
[187] *Id.*
[188] *Id.* art. 20.
[189] *Id.* art. 22 (does not allow contracting out of arts 15- 18 related to the enforcement).
[190] *Id.*
[191] The discussion in this section encompasses both the *Rahn* Law and the principles of Islamic *Shari'a* relating to secured transactions discussed *supra* in this Chapter.
[192] *See* Chapter One on *riba* and *gharar*.

However, the question is whether the promulgation of the new security collateral law into the Saudi legal system have brought about a comprehensive and a sound secured transactions law or whether such law would be frustrated in practice given the nature of modern financing transactions. The Saudi security laws (both pre and post 2003) need to be measured against their effect to access credit and to their enhancement as to the predictability and transparency of the legal framework. Earlier in this Chapter we have discussed the standards of a sound and market-friendly secured transactions law which can be summarised and founded on five key elements.[193] Firstly, the security right should adhere to essential qualities of the right; that is - a right *in rem* and should grant a super-priority status to its holder against all other creditors.[194] Secondly, the law should allow for the grant of security in the widest possible range of circumstances. Thirdly, the existence of a security interest over the secured asset must be effectively publicised. Fourthly, the *means* of recovery of the debt should be rapid and cost-effective. Finally, any costs to create and maintain the security right should be kept to a reasonable level.

Taking a broad approach, Saudi law does not to some extent implement these principles. While the security interest under the Saudi law is a right *in rem* and it gives its holder a super-priority status;[195] there are certain restrictions as to the other above-mentioned elements. Firstly and generally, Saudi law does not provide for the granting of security in the widest range of circumstances. Saudi law does not allow the creation of security over future assets.[196] The prevention applies to both movable and immovable assets and it has been referred to expressly in the CRL. Such could

[193] D. Fairgrieve, *'Reforming Secured Transactions Laws in Central and Eastern Europe'*, EBLR, 245, (1998).
[194] Simpson et al., *supra* note 3, at 145-146.
[195] While this is the general rule under Islamic *Shari'a*; there is no explicit mention in the *Rahn* Law as to the priority status of the secured creditor.
[196] Similarly, security interests against future debts cannot be granted.

be problematic to project finance transactions where most of the security collateral is "after-acquired" or "after-constructed". Likewise, in inventory financing debtors might acquire new items of inventory on on-going basis. This means that under Saudi law parties would have to conclude a *rahn* agreement every time an asset is acquired.

Also, certain restrictions appear in relation to the granting of security over movables. While the CRL came about in order to increase certainty in the granting of security over movables; it still provides for the possession of the secured asset in order to be effective. Possession of the secured asset has been argued to impede extension of credit and discourage investment. However, the CRL may have recognised constructive possession of the secured assets. As mentioned above, Article 7 of the CRL considers the creditor in possession of the secured assets if the creditor receives a document which entitles him and no one else to receive the secured assets. The implications of Article 7 in allowing the debtor to use the secured assets, however, are not yet clear in practice. Also, the scope of security in rights is not very clear under the Saudi law. The CRL has referred specifically to certain types of security in rights which are represented in an instrument. For example, bills of exchange and cheques can be secured according to certain procedures provided by the CRL. The fact that these rights are represented in instruments enables the creditor to possess the instruments; and in turn, satisfying the possession requirement for an effective *rahn* stipulated by the CRL.

On the other hand; there is no clear reference as to security in rights over receivables in the CRL. Taking security over receivables is of great importance in modern financing as large part of the wealth of the economy is locked up in receivables.[197] In project financing, for example, security in rights over receivables play a very important role.[198] As receivables are considered intangible movables;[199] securing such receivables fall under the CRL. However, certain provisions in the CRL may preclude taking security over receivables. Thus, under the CRL the secured asset must be one that can be sold. No mention in the law as to the definition of the saleable assets; and hence, recourse to such definition would be to the paramount Islamic *Shari'a* which prohibits the sale of debt (*i.e.*, receivables) as explained in Chapter Three. Also, the CRL does not recognise granting future assets as security collateral and stipulates that assets should exist at the time of granting the security. These provisions frustrate any attempt to take security over receivables under the Saudi law that could be generated in a project finance transaction for instance.

The third element for a sound secured transactions law is the effective publicity of the security interest. Effective publicity is important to avoid false wealth and to prioritise the different competing creditors.[200] In Saudi Arabia there is no registration system, and registering a *rahn* is effected through a system of recordation by Public Notaries that only applies to real property. Recording is according to personal recordation system in the name of the owner of the real property.[201] The Public Notaries will hand the title deed of the secured real property to the security grantee inscribed with the *rahn* on the deed itself. The security grantor is not precluded from obtaining a new title deed instead of the one given to the grantee if the grantor claim the deed is lost for example. Hence, unscrupulous debtors may obtain a new title

[197] MCCORMACK, *supra* note 29, at 209.
[198] In project finance transactions, lenders usually rely on the cash flow generated by the project for repayment.
[199] *See generally* WOOD, *supra* note 52, at 32.
[200] WOOD, *supra* note 52, at 110.
[201] McMillen, *supra* note 103, at 1222 n. 55.

deed and sell or re-provide the real property as security to a different creditor.[202] Such situation is unsatisfactory and hence it can be argued that the present recordation system is not very effective.

Another problem is, as mentioned earlier, that Public Notaries have refused to register security interest for banks on the ground that banks do deal with interest-bearing transactions which are against the Islamic *Shari'a*. The banks, therefore, had to rely on other *means* in order to secure and record its security interests.[203] Such *means* involved the recordation of the security interest in the name of an employee of a bank or a company for the benefit of the bank. The bank then enters into an agreement with this employee/company to secure its rights. These techniques are not sufficient and can not accommodate a market-led financial system. As for the movable assets, the CRL does not provide for any registration system although it provides for certain procedures to evidence the security interests in instruments. Presumably, no registration system exists because the possession of the secured assets serves such purpose. It can be concluded, that the publicity element in the Saudi secured transactions law is not very satisfactory.

Fourthly, the Saudi legal system does not appear to provide a rapid and cost-effective means of recovery. The Saudi law would not allow a private sale of the secured assets or "self-help". Enforcing the security must be through the competent judicial body. This, however, could be subject to different bodies and laws. Consider the case where a creditor has security interests over the debtors' assets which include of: immovable, movables, and securities. The *status quo* seems to suggest that in order for the creditor to enforce his rights over these assets; the creditor has to go through different judicial bodies. To obtain an enforcement judgment over

[202] *Id.*
[203] *See* discussion *supra*.

immovables; creditors have to go through Islamic *Shari'a* courts which apply Islamic *Shari'a*. Enforcement over movables would be through another committee which deals with the CRL and its provisions regarding the enforcement.[204] Similarly, the rest of the assets are enforced through different committees which might apply different procedures. Such enforcement mechanisms are time-consuming and no cost-effective.

As for the methods of enforcement under the Saudi law; it has been clearly referred to in the CRL as opposed to other laws. Under the CRL which govern movables; the method of enforcement is through public auction. Normally, the intention of a public auction under the supervision of the court is to protect the debtor.[205] Generally, court orders to enforce the security collateral through public auctions cause delays and costs to both parties.[206] Private sale, on the other hand, allows for rapid disposal of the secured assets without delays. Unlike the CRL, Islamic *Shari'a* has no clear method of enforcement but it has to be judicially driven.

Another issue which is related to the efficiency of security enforcement is the grace periods. While Islamic *Shari'a* does not stipulate for any grace period, the CRL does provide for a three days before filing for enforcement through the court. Even after the grant of the enforcement decision by the court; the creditor is allowed to seek enforcement only five days after notifying the debtor. It can finally be concluded that the Saudi secured transactions law still needs further consideration in order to further improve the law that can meet the requirements of the Saudi conventional finance component.

---

204 *See generally* arts 15 – 16, *Rahn* Law, *supra* note 19.
205 WOOD, *supra* note 52, at 142.
206 *Id.* (refers that a delay between one to five years through such procedure)

4.4 FINAL OBSERVATIONS

Despite the Saudi initiatives, the above discussion reveals that the law of secured transactions in Saudi Arabia has not been adapted in line with the general market-based economy policies that Saudi Arabia aims to adopt. The law of secured transactions, therefore, does not play a facilitating role for the Saudi conventional finance component. While the CRL has been introduced as a new security collateral law to govern movable assets; such law in the author's view, has only codified certain Islamic *Shari'a* principles which might add some form of certainty but substantively the status of the Saudi security collateral laws have not experienced remarkable change. Hence, the position remains that there is an *existing de facto duality* and a possibility of further interaction between the conventional finance component and Islamic *Shari'a*.

In addition, as mentioned previously; a well-developed secured transactions law works hand in hand with a supporting strong insolvency law. This is true in case of any emerging market country which aims to develop its existing financial system such as Saudi Arabia. However, it seems that the Saudi government has been neglecting this area during the legal reform period that Saudi Arabia is witnessing recently. The fact that there is no comprehensive insolvency law in Saudi Arabia adds another dimension in terms of the interaction between the Saudi conventional finance component and the Islamic *Shari'a*.

While Islamic *Shari'a* has dealt with insolvency; the current market-led reforms in Saudi Arabia require the existence of a set of rules that govern modern insolvency situations such as insolvency in case of companies.[207] Thus, the Saudi

[207] Islamic *Shari'a* would normally deal with individual bankruptcies.

Company Law does not deal with such situations.[208] Surprisingly, however, Saudi Arabia has introduced a Scheme of Arrangement Law (the Scheme Law),[209] that allow for companies to reach an arrangement with their creditors regarding their financial status. The Scheme Law, despite its amicable nature, is the only law that addresses insolvency related issues in Saudi Arabia.

Having discussed thoroughly the legal issues resulting from the interaction between the Saudi conventional finance component and Islamic *Shari'a* in relation to the area of secured transactions and having highlighted other related concerns such as insolvency laws; it is fair to argue that there is still more to be done in both areas of law in order to facilitate the establishment of a market-led legal infrastructure. The legal issues that have been discussed are the result of the *existing de facto duality*. In attempting to contain the "legal unrests" created by the *existing de facto duality* in the area of secured transactions; lawyers have been creating structures that contained "local ingredients" of Islamic *Shari'a* in Saudi Arabia. In addition, "Islamic finance", as argued in this Chapter, has been used as a *means* of financing that provides a reasonable balance between the availability of funds while maintaining security collateral to acceptable levels. The rest of this Chapter sheds more light in this regards.

[208] However, the Saudi Company Law does deal with liquidation. *See generally* Company Regulations, Royal Decree No M/6, July 1965 *available at* http://www.commerce.gov.sa

[209] The author has endeavoured to provide a translation that reflects the purpose of the law. A literal translation of the law would read "the law of settlement that prevents insolvency". For convenience this law is referred to as the Scheme of Arrangement Law. *See* THE SCHEME OF ARRANGEMENT LAW, M/16, *available at* http://www.commerce.gov.sa

5. THE *EXISTING DE FACTO DUALITY* AND SECURED TRANSACTIONS: TENSIONS AND CONSEQUENCES

In the area of secured transactions, the *duality* and its implications, which is the theme of this volume, is bifurcated. Firstly, the conventional finance component is functioning within the Islamic *Shari'a* security collateral laws. The implications are clear - that is; the unavailability of certain security collateral rules that meet the needs of the Saudi conventional finance component and the refusal by the Saudi Public Notaries to register security interests in favour of the conventional banks on the ground that these banks deal with interest-based transactions which are against the Islamic *Shari'a*. Secondly, the attempt to modernise the Saudi security collateral laws through introducing the CRL which governs movable assets. However, this law itself is functioning within an Islamic *Shari'a* and it will always be viewed and interpreted from an Islamic *Shari'a* perspective.

It can be argued, therefore, that the *existing de facto duality* in Saudi Arabia as it pertains to secured transactions law is creating a tension within the Saudi legal system leading the legal and the financial communities to create solutions or to invoke alternatives in order to circumvent potential legal obstacles. An example is the "*rahn adl*" structure which is developed as a collective security arrangement in financing transactions. It is believed that the use of the "*rahn adl*" structure contributes in minimising several difficult issues under the Saudi law.[210]

Furthermore, it can be argued that a consequence of the tension arising from the *existing de facto duality* is the growing "Islamic finance" practice in Saudi Arabia. Thus, because the Saudi secured transactions law may not meet the lenders' expectations; "Islamic finance" offers a functional equivalent *means* of finance that

[210] McMillen, *supra* note 103, at 1211.

incorporates a "*quasi*-security" function. In other words, the growing use of "Islamic finance" in Saudi Arabia is not only attributed to the fact that Islamic *Shari'a* prohibits *riba* or interest but also because there is a legal dimension in using these "Islamic finance" structures. In this sense, "Islamic finance" structures serve as an *alternative* but not a *substitute* for conventional secured finance practices.

This Chapter argues that "Islamic finance" offers a "*quasi*-security" effect tantamount to certain conventional finance techniques; sometimes referred to as "ownership-based funding techniques", "finance sales",[211] "title financing", "vendor/lessor security" or "asset-based finance".[212] These transactions have the commercial effect of security in the form of sale or lease as will be explained further below.[213] The Chapter continues to argue that the "*quasi*-security" function of "Islamic finance" provides somewhat an incentive for its use in the Saudi financial system. In addition, being compatible with the paramount legal system of Islamic *Shari'a* in Saudi Arabia, "Islamic finance" can be absorbed easily within the prevailing Saudi "credit culture".

5.1 LEGAL WORK AND THE DEVELOPMENT OF SECURITY STRUCTURES IN SAUDI ARABIA

One of the primary concerns for lenders and lawyers in Saudi Arabia is to develop security structures that meet their needs. To this effect, law firms through their legal

[211] *See generally* JAN DALHUISEN, DALHUISEN ON INTERNATIONAL COMMERCIAL, FINANCIAL AND TRADE LAW, Chapter 5 (Hart Publishing, 2004). Some of the ownership-based funding techniques which will be discussed are referred to as "*quasi*-security"; *see* MCCORMACK, *supra* note 29, at 51. Other "*quasi*-security" devices which are not covered in this Chapter include: debt subordinations, negative pledges, *Quistclose* trusts, *Ramalpa* clauses and set-off agreements. *See generally* ALI, *supra* note 4, at 175 and S. WORTHINGTON, PROPRIETARY INTERESTS IN COMMERCIAL TRANSACTIONS, (Clarendon Press, 1996). *See also* GOODE, *supra* note 113, CHAPTERS (26-28).

[212] PHILIP WOOD, TITLE FINANCE, DERIVATIVES, SECURITISATIONS, SET-OFF AND NETTING, at 4 (Sweet & Maxwell, 1995).

[213] Wood, *supra* note 20, at 46.

work, have provided 'micro-solutions' for 'macro-problems'.[214] Legal work is defined as the "technical work, with and on the law, undertaken usually but not necessarily by lawyers, in specific transactions for specific clients".[215] In Saudi Arabia, secured transactions have been a fertile area for legal work innovations due to the importance of security collateral for international lenders in financing transactions.

One of these examples is the development of the "*rahn adl*" structure. McMillen summarises the structure explaining: "American and European financings usually involve a trustee that holds collateral on behalf of lenders. The *Shari'a* does not provide for trustees, at least in a Western sense. However, the *Shari'a* has long experience with a similar concept the *adl*. In brief, an *adl* is a trusted and honourable person selected by both the lender and the borrower, a type of "trustee-arbitrator" having certain fiduciary responsibilities to both parties".[216]

The "*rahn adl*" structure is developed for the use in international project finance transactions in Saudi Arabia. Although the structure has been criticised for being 'cumbersome', such opinion has overlooked the fact that the "*rahn adl*" structure has been used as a collective security arrangement and it is not a mere security package.[217] A collective security arrangement is an "an arrangement whereby security is held for the common benefit of a number of lenders".[218] In the light of this, one can view the above description of the "*rahn adl*" structure by McMillen as a collective security arrangement and as an alternative to the security trustee structure

[214] McBarnet, *supra* note 13, at 99.
[215] *Id.* at 98-99.
[216] McMillen, *supra* note 103, at 1211.
[217] *See* the criticism by Graham Methold et. al., *Saudi Law Cogent Cogen: Tihama Cogen's Structure Combines Both English and Saudi Security Law without being Cumbersome*, 250 PROJECT FIN. & INFRASTRUCTURE FIN. 51, at 52, (2004).
[218] THIELE, *supra* note 15, at 1.

which is normally used in America and Europe. The driving force behind developing such structure was the need to meet the challenge in developing a security structure that meets project financing and related credit requirements of all the involved banks as well as the borrower.[219]

McMillen adds "a structure had to be developed that met the traditional requirements of New York and English financing but was consistent with the *Shari'a*".[220] In this sense, it can be argued that the "*rahn adl*" structure is a consequence of the tension created by the *existing de facto duality*. Since the conventional finance component is functioning within the Islamic *Shari'a* which does not offer the "security trustee" structure available else where, the conventional finance component is searching for a structure that share commonalities with the "security trustee" structure.

At this stage, the legal work has filled this gap by developing the "*rahn adl*" structure.[221] While such legal work should be encouraged; the use of the "*rahn adl*" structure as a collective security arrangement is questioned. Thus, the "*rahn adl*" structure should meet the practical requirements mentioned earlier in this Chapter. However, prior to any discussion of the efficient use of the "*rahn adl*" structure, an overview of the law of "*rahn adl*" is helpful.

---

[219] McMillen, *supra* note 103, at 1206.
[220] *Id.* (explains further, however, that the methodology which has been used in the developing such structure was to build the structure from the Islamic *Shari'a* law and then add some modifications to incorporate procedures and structures from the Western law. He criticises the methodology where the structures has to be modified to fit a pre-exiting Western model).
[221] McBarnet, *supra* note 13, at 106 highlights the role of lawyers stating: "...of particular interest ...is the lawyer's technical skills in problem-spotting and problem solving through contract drafting. In particular, it is the way contract is used to tackle what are perceived, from cross-border perspective, as regulatory lacunae. The result is legally binding constructed through contracts to compensate for regulatory gaps. Legal work creates public law surrogates through private law- it constructs 'private public law'".

5.1.1 THE LAW RELATING TO THE USE OF ADL AND ITS APPLICATION IN SAUDI ARABIA

The *adl* is a trusted third-party chosen by both the security grantor (debtor) and the security grantee (creditor) to hold the security.[222] Islamic *Shari'a* allows for the *adl's* involvement on the condition that all parties agree to such structure including the *adl*.[223] Hence, if the creditor has involved a third-party to possess the secured assets without an agreement with the debtor; such third-party is not considered to be an *adl* but a representative of the creditor.[224] It appears then that creating a "*rahn adl*" structure is a tripartite contract whereby the three parties should agree to the details of the structure. The question is, however, what is the Islamic *Shari'a's* view as to the legal construction of such contractual relationship. It seems that that Islamic *Shari'a* considers such structure as an agency relationship. Thus, the *adl* is an agent of both the creditor and the debtor.[225]

When the *adl* takes possession of the secured assets the *rahn* agreement is complete and irrevocable.[226] The *adl* is not allowed to give the secured asset neither to the debtor nor to the creditor without the consent of the other.[227] If the *adl* returns the assets to either party he has the right to demand it back. The *adl* can not sell the secured assets without the consent of both parties.[228] Such consent, however, can be provided in advance when drafting the *rahn* agreements.[229] An important issue here is the Islamic *Shari'a's* treatment of the contractual relationships among the parties as one of agency. Such treatment would involve the Islamic *Shari'a's* rules

---

[222] THE MEJELLE, *supra* note 121, art. 705,
[223] *Id.* art. 752.
[224] ALI QASEM, *TASURFAT AL-ADL FI AL-MARHON*, at 29-30 (Dar Al-Jama'a Al-Jadida, 2002).
[225] *Id.* at 30.
[226] THE MEJELLE, *supra* note 121, art. 752
[227] *Id.* art. 754.
[228] *AL-SHRI'YAH, supra* note 140, art. 1015, at 342.
[229] McMillen, *supra* note 103, at 1216.

governing agency. Such may undermine the objectives desired from such structure because agency arrangements under Islamic *Shari'a* are revocable at the will of either party.[230] If so, the debtor will be able to prevent the *adl* from selling the secured assets by simply terminating the agency. Such is an undesirable result in financing transactions.

However, McMillen argues that such structure is applied in Saudi Arabia with some degree of irrevocability. He states: "...even under construction of relevant *Shari'a* precepts by jurists applying the *Hanbali* School of Islamic Jurisprudence, the use of a *rahn adl* structure confers a degree of irrevocability not otherwise found".[231] No indication is provided by McMillen as to the extent of this "degree of irrevocability"; but he raises several issues to underpin his argument of irrevocability as it pertains to the "*rahn adl*" structure in Saudi Arabia. Firstly, he refers to the principle that the agency is irrevocable when there is a third-party relying on such irrevocability.[232] But he further explains that there is a debate among *Hanbali* School scholars in Saudi Arabia as to the extent of its applicability.[233] Eventually, he argues that the *Hanbali* School would give the narrowest interpretation to the revocability.[234] While this might be the case; this statement does not back his argument that using the *adl* under the *Hanbali* School "confers a degree of irrevocability not otherwise found".

The second issue which McMillen raises to back his view of irrevocability is, according to him, the trend in Saudi Arabia "towards the recognition of irrevocability

[230] *Id.* 1213.
[231] *Id.* 1214.
[232] *Id.*
[233] *Id.*
[234] *Id.*

in certain situations".[235] Thus, he gives an example of a Saudi case where the court indicated that an agency is not revocable in case there is a specified term for its existence.[236] While again this might be the case, but as he pointed out at the outset; Islamic *Shari'a* in Saudi Arabia does not recognise precedents.[237] So, such trend can not be relied upon as a solid legal basis for his argument of "irrevocability not otherwise found".

The third issue he raises is that the Committee for the Settlement of Banking Disputes[238] would normally apply the agreements as signed between the parties even if these agreements were in contradiction with Islamic *Shari'a.*[239] While this is a valid argument; but such Committee has a jurisdiction only if one of the litigant parties is a bank. When an *adl* is involved in the financing transaction we have three parties; that is, the bank, the borrower and the *adl*. The borrower may wish to bring a legal action against the *adl* to prevent him from enforcing the security collateral through sale. If the *adl* is a non-bank entity, the Committee referred to by McMillen no longer has jurisdiction over such dispute. Another Committee might have jurisdiction and hence a higher possibility of applying the Islamic *Shari'a.*[240]

Nevertheless, there is no clear authority for McMillen's argument that when structuring a "*rahn adl*" under the *Hanbali* Islamic school there is "a degree of irrevocability not otherwise found". Most importantly for the lenders in this regards is the ability of the *adl* to sell the secured assets upon enforcement. In the "*rahn adl*" structure, and the ability of the *adl* to sell the secured assets, there are four possible

[235] *Id.* at 1215.
[236] *Id.*
[237] *Id.* at 1184.
[238] *See generally* Chapter Two on the Committee for Settlement of Banking Disputes.
[239] McMillen, *supra* note 103, at 1215.
[240] Even if the *adl* is a bank entity, there could be potential difficulties in enforcing the security collateral due to the bank's involvement in interest-bearing transactions.

scenarios which may occur:[241] 1) both parties (*i.e.*, the creditor and the debtor) agree that the *adl* sells the secured assets on the due date and such authorisation is not terminated until that date, 2) that both parties wish to terminate the authorisation for the sale of the assets, 3) that the debtor/security grantor wishes to terminate such authorisation and 4) that the creditor/security grantee wishes to terminate such authorisation.

In the first scenario the question is whether the *adl* can sell the secured assets with no further consent from both parties. According to McMillen, such consent can be provided in advance when drafting the *rahn* agreement.[242] However, some Islamic schools, including the dominant *Hanbali* School in Saudi Arabia, do require that the consent should be re-obtained from the debtor in order for the *adl* to be able to sell the secured assets.[243] Such would frustrate the aim of the "*rahn adl*" structure.

The second scenario does not constitute obstacles to the structure because it is the will of both parties. As for the third scenario, it can raise certain concerns for the lenders because if the debtor is allowed to terminate the authorisation to sell the secured assets; the main aim of the structure is undermined. In this regards, two Islamic schools, including the dominant *Hanbali* School in Saudi Arabia, opine that the authorisation can be terminated.[244] In the forth scenario, the *Hanbali* school, *inter alia,* opines that the *adl* can be prevented from selling the secured assets.[245]

Having reviewed the opinions of the Islamic schools and in particular the *Hanbali* School referred to by McMillen to grant "a degree of irrevocability not otherwise

[241] QASEM, *supra* note 224, at 162-174.
[242] McMillen, *supra* note 103, at 1216.
[243] Ali Qasem, *supra* note 224, at 163; *Shafai* School does not require consent from the debtor.
[244] *Id.* at 166. The other two schools (*Hanafi* and *Malaki*) opine that the *adl* is not terminated. The *Hanafi*, however, go further in details and distinguish between whether the authorisation of sale was stipulated in the *rahn* agreement or not; see *Id.* at 167.
[245] However, the *adl* remains in his position as an *adl* but the *Shafi* school opine that in the forth scenario the *adl* will be prevented from the sale and removed from his position as an *adl*. *See* QASEM, *supra* note 224, at 171.

found"; it is unlikely that we reach the same conclusion. In fact the *Hanbali* School is the one which grants the debtor the power to prevent the sale. Hence, contrary to McMillen's statement, the revocability of the agency in regards to the sale of the secured assets is highly possible under the *Hanbali* School.

However, McMillen did explain the variations among Islamic *Shari'a* scholars and the difficulty in achieving consensus on novel issues.[246] Faced with such dilemma, it seems that McMillen himself has departed from the *Shari'a*-based legal construction of the contractual relationship among the parties under the "*rahn adl*" structure and made it clear that "an agency relationship was not, and is not, contemplated, and that the rights afforded the Security Agents [the *adl*] on behalf of the [banks] are irrevocable...". Islamic *Shari'a* does provide, however, that the contractual relationship between the *adl* and the other parties is one of agency; a fact which McMillen wishes to circumvent in order to avoid any legal ambush that may result from the revocability issue. However, superimposing "*rahn adl*" structure over the "McMillen-type" structure might be defeated in practice and could be re-characterised as agency-based "*rahn adl*" structure.

5.1.2 COLLECTIVE SECURITY ARRANGEMENTS USING THE ADL

The discussion of the "*rahn adl*" structure can be further expanded to examine the implied proposal by McMillen that such structure can be used as a collective security arrangement. In doing so, there is no particular reference to McMillen's transaction discussed earlier but the "*rahn adl*" structure will be further analysed in the light of the practical requirements for a good collective security arrangement mentioned earlier in this Chapter. The first practical requirement for a good collective security arrangement suggests the possibility to create a security collateral without having to

[246] McMillen, *supra* note 103, at 1190.

name or register the individual lender. Under the "*rahn adl*" structure, the position seems that the lender should be known as a contracting party to the *rahn* agreement *ab initio*. So, the structure does not meet the first practical requirement.

The second requirement requires the possibility to appoint one person to be in charge of monitoring and enforcing the security. This is a requirement which is in line with the elements of "*rahn adl*" structure. The third requirement deals with the proper protection of the secured assets. In this regards, the creditors should not be exposed to the *adl's* insolvency risk and should be able to pursue their claims against third parties in case the *adl* breaches his obligation. The "*rahn adl*" structure would meet such a requirement. The forth requirement is that the lenders' rights in respect of the security must be easily transferable. This is one of the most important practical requirements due to the flexibility given to the lenders involved in project financing and syndicated loans to transfer their loans.

However, loans are normally transferred through novation. This means that a new debt in favour of the new creditor is created and that the old debt is extinguished.[247] If such transfer takes effect in the absence of a "security trustee", the transfer will have a detrimental effect on the security by being discharged and no longer in existence for the benefit of the new creditor. The new creditor is not considered as the legal successor of the selling creditor; and it cannot become a party to the existing security by ratifying the acceptance of such security on its behalf.[248] This means that the security collateral interest should be re-created in the favour of the new creditor. Such is considered to be cumbersome and costly.[249] Also, the new

[247] PHILIP WOOD, INTERNATIONAL LOANS, BONDS AND SECURITIES REGULATION, at 115 (Sweet &Maxwell, 1995).
[248] THIELE, *supra* note 15, at 152.
[249] *Id.* at 153.

creditor might have a weaker priority position.[250] The use of the "security trustee" structure as a collective security arrangement has been innovated to avoid such practical obstacles. To further understand the forth practical requirement, one should consider the advantages of using the "security trustee" structure as a facilitator of loan transfers.

When a security trustee is involved in the financing transaction, the trustee holds the security collateral on trust for the benefit of the lenders.[251] Under the "security trustee" structure, the lenders are the beneficiaries of the trust. So, while there could be contractual relationships between the lenders and the security trustee; the lenders' rights in relation to the security collateral derive mainly from the fact that the lenders are the beneficiaries of the trust. The nature of the structure as being one of a trust rather than one of a contract is the key to facilitate the transferability of the loans.

Any person or class of persons can be the beneficiaries of the trust as long as the beneficiaries are described and ascertainable for the purposes of executing the trust.[252] Hence, the security trustee can hold the security collateral for the benefit of the potential lenders that may participate in the loan arrangement at any time in the future.[253] Therefore, the existing lenders can trade their loans and there is no need to re-create the security in favour of the new lenders.

Now the question is whether the "*rahn adl*" structure does meet the transferability requirement being an essential practical requirement for a good collective security arrangement. In other words, does the "*rahn adl*" structure provide as a collective security arrangement the flexibility in transferring the loans without affecting the security collateral. The legal nature of the "*rahn adl*" structure appears to suggest

[250] *Id.*
[251] *Id.* at 159.
[252] *Id.*
[253] *Id.*

that it is unlikely for the structure to provide the flexibility for transferring the loans. Unlike the "security trustee" structure, the "*rahn adl*" structure is one of contract. The lenders in a "*rahn adl*" structure are not beneficiaries of a third-party (*i.e.*, the *adl*) but they derive their rights in relation to the security collateral from the existing contractual relationship as opposed to the existing trust under the "security trustee" structure.

Under the "*rahn adl*" structure, if the lender sold its loan to a new lender; the contractual relationship among the old lender, the borrower and the *adl* is vanished. This, in turn, affects the existing security collateral arrangement between the parties and hence; the new lender will have to re-create the security collateral in its favour which is an undesirable result. This seems to suggest that involving an *adl* to hold the security collateral does not provide any benefits in regards to loan transferability. Therefore, it can be concluded then that the "*rahn adl*" structure does not meet the forth practical requirement.

The fifth practical requirement requires that the security collateral which is granted under the collective security arrangement should cover new loans even if they are made by new lenders. This is to facilitate the financing structure and to allow the new lenders to join the existing arrangement. However, as discussed previously, under Islamic *Shari'a* neither future assets can be granted as security collateral for a present debt nor existing assets can be granted as a security for a future debt.[254] So, the "*rahn adl*" structure does not meet the fifth practical requirement. As regards the sixth practical requirement, there is no obstacle in changing the *adl* under the "*rahn adl*" structure if the parties desire to do so. Finally,

[254] However, there is an exception to the general rule; that is, Islamic *Shari'a* allows for the debt to increase and remain secured by the same assets; such can not be included in the original contract and it has to be agreed to specifically afterwards.

the last practical requirement is that the arrangement should be as simple and straightforward as possible. This is a matter of the jurisdiction where the "*rahn adl*" structure is taking place.

Having analysed the "*rahn adl*" structure, it can be concluded that the "*rahn adl*" structure is unlikely to constitute a good collective security arrangement. The use of the "*rahn adl*" structure by McMillen in a specific financing transaction in Saudi Arabia may have added some benefit to that transaction *per se* but it does not qualify the structure as a good collective security arrangement with general application as such. Law firms keep competing in attempting to provide a good security package in Saudi Arabia that deal with the tensions and "legal unrests" that have resulted from *existing de facto duality*.[255] While this might solve certain problems at the *micro* level; it does not at the *macro* level.

5.2 ALTERNATIVE MEANS TO CONTAIN THE TENSIONS: THE EMERGING "ISLAMIC FINANCE"

The discussion in this Chapter reveals that there are "legal unrests" resulting from the *exiting de facto duality* in the area of secured transactions. There is an unease in taking security collateral interests in Saudi Arabia. Even the "legal work" undertaken by major law firms does not solve the problem at the *macro* level and it does increase transaction costs because these law firms prefer to keep these innovated "legal technologies" to themselves and to specific clients. The author would even argue that these structures lack the legal certainty in relation to their enforcement *etc*. Thus, since these structures are new to the market; one is not certain to what extent such structures are enforceable in Saudi Arabia.

[255] *See e.g.*, Methold et. al., *supra* note 217, at 52 (discussing a security collateral package structured by a leading US law firm, Milbank, Tweed, Hadley & McCloy).

As discussed earlier, the availability of good secured transactions laws encourages the extension of credit. However, since the Saudi secured transactions laws are experiencing "legal unrests" resulting from the *existing de facto duality*; the availability of credit could be constrained. Having said that, the author perceives the development of "Islamic finance" in Saudi Arabia as a consequence of the *existing de facto duality*. Thus, it can be argued that "Islamic finance" is a *means* to provide finance using Islamic-compliant structures that do not require, to a certain extent, security collateral rules in the conventional sense. In fact, certain "Islamic finance" structures provide a *quasi*-security function.

Quasi-security interests are "devices that perform the economic function of a security interest- that is, they provide support for the payment or performance of an obligation- without, as a general rule, conferring on the obligee rights *in rem* in respect of the property of the obligor (or that of a third-party guarantor).[256] As mentioned earlier, a *means* of financing which is believed to provide some form of *quasi*-security function is "title finance". To elaborate, there are two ways to raise funds;[257] these are: 1) the debtor can take out a loan and provide his assets as security collateral; or 2) the debtor can sell his assets in return for the purchase price which provides him with the liquidity he desires.

The latter *means* of financing is different from the former; but both *means* of financing could become more similar, in case that the sale of assets is made on the condition that the debtor/seller repays the purchase price on a specific date in return for his assets.[258] In jurisdictions where non-possessory security collateral interests are not recognised; "title finance" techniques have been advantageous because these

[256] ALI, *supra* note 4, at 175.
[257] DALHUISEN, *supra* note 211, at 755.
[258] *Id.* at 756.

techniques have allowed for the debtor/seller to raise funds while keeping possession of the assets.[259] The main aim of these "title finance" techniques is "to avoid what are seen as the archaic obstacles of mortgage or pledge law".[260]

By way of analogy, "Islamic finance" techniques have similarities with these "title finance" techniques.[261] Therefore, the development of the "Islamic finance" component in Saudi Arabia can be perceived as a consequence of the "legal unrests" created by the *existing de facto duality* and the interaction between the Saudi conventional finance component and Islamic *Shari'a*. Martin highlights the "*quasi*-security" function of "Islamic finance" stating: "when taking security the Islamic financier ...is often in a much stronger position than a conventional banker in that he is either an owner or lessor. This is likely to be the case with trade finance. As an owner or lessor of goods his security is less likely to be compromised by claims from other lenders. If a bank owns the asset then the claims of other creditors are likely to become less significant".[262] While Martin has specifically referred to trade finance; "Islamic finance" structures have expanded to encompass other sophisticated transactions such as Islamic project finance and Islamic securitisations.

Generally, the *quasi*-security effect of title finance techniques is divided into 'vendor-security' and 'lessor-security'. 'Vendor-security' techniques include retention of title to goods, factoring, forfaiting and sale and repurchase. As for the 'lessor-security' techniques, it includes finance leasing, hire purchase and sale leaseback.[263] There are different reasons that influence the parties' decision to choose

[259] *See generally id.*, 753-760.
[260] Wood, *supra* note 17, at 46.
[261] However, there are some differences in order to comply with some Islamic *Shari'a* requirements.
[262] Jeremy Martin, *Security in Islamic Banking, in* EUROPEAN PERCEPTIONS OF ISLAMIC BANKING, at 69 (Institute of Islamic Banking and Insurance, 1996).
[263] *See generally* WOOD, *supra* note 212, at 5.

the form of financing and its corresponding security collateral package.[264] One of the main reasons for choosing "title finance", however, is its commercial effect as security collateral which could provide a level of comfort to the financier especially when financing is taking place in a jurisdiction that does not maintain a good secured transactions law.

Under Islamic *Shari'a*, there are certain techniques that have developed in order to avoid certain Islamic *Shari'a* prohibitions such as *riba*, the need to transfer possession, court enforcement mechanisms and the ban on granting of security over certain types of real property.[265] However, as the author of this volume argues, these techniques are similar to "title finance" techniques and have been used in "Islamic finance" transactions. Hence, these techniques have the same commercial effect of security and provide a *means* of financing that provides a functional equivalence to conventional finance in Saudi Arabia.

In Chapter One, the author explained the various "Islamic finance" modes. Of these "Islamic finance" modes; there are certain modes such as leasing (*ijara*) and hire purchase (*ijara wa-iqtina*) that do resemble "title finance". However, other various structures have been adopted in Islamic financing transactions[266] including: sale repurchase (*bay' bil-wafa'*) and sale leaseback (*bay' bil-istighlal*).[267] When taking a closer look at these Islamic structures; one can see the its similarity with other conventional finance title finance techniques.[268] Certain adjustments would

---

264 *See generally* GOODE, *supra* note 113, 691- 699.

265 Foster, *supra* note 106, at 146. Foster refers to these mechanisms under the category of *hiyal*; translated as "stratagems", "fictions" or "devices" because they were devised to circumvent Islamic law principles.

266 *See* S. Masanuzzaman, *Islamic Law and Finance*, *in* ENCYCLOPAEDIA OF ISLAMIC BANKING AND INSURANCE, 67, at 71 (Institute of Islamic Banking and Insurance, 1995).

267 *Id.* at 146-147. Also other techniques such as *'ina* (double sale).

268 To avoid confusion between title finance techniques used by conventional financiers and similar Islamic financing techniques used by Islamic bankers; we will refer to the former as *conventional* title finance and to the latter as *Islamic* title finance.

need to be considered, however, to meet *Shari'a* requirements such as the prohibition of *riba* and *gharar*.

Consider, for example, the *conventional* sale and repurchase technique whereby the debtor sells an asset to a financier on the condition that the debtor will repurchase the same asset from the financier on a specific date. The repurchase price does include a mark-up as a reward for this service.[269] Such transaction, however, is different from a secured transaction because it has a different risk and reward structure.[270] Under this structure, the financier/buyer upon the purchase of assets becomes the full owner of the assets. This entitles him in case of the debtor/seller's bankruptcy to retain the assets or, if the assets were under the debtor's possession, to repossess the assets.[271] In principle, the *Islamic* sale and repurchase structure does not differ from its *conventional* counterpart. The debtor sells an asset to the financer on the condition that the debtor repurchases the asset. The asset is effectively a security for the funding provided to the debtor.[272] However, there are certain weaknesses under the *Islamic* sale and repurchase structure namely; the requirement that the financier has to obtain the debtor's consent in order to be able to dispose of the asset and the necessity to give up possession.[273]

Another technique is the *conventional* sale leaseback. Under this structure, the debtor/seller sells an asset to the financier/buyer; whose in turn leases it back to the debtor. The lease instalments comprise amounts equal to principal and interest.[274] Islamic *Shari'a* offers a similar structure whereby the debtor/seller sells the assets and the financier/buyer will buy it and lease it back to the debtor. The contract may

[269] DALHUISEN, *supra* note 211, at 877.
[270] *Id.* at 876.
[271] *Id.* at 877.
[272] Foster, *supra* note 111, at 146.
[273] *Id.*
[274] WOOD, *supra* note 212, at 8.

contain a provision which allow the debtor to repurchase the assets.[275] As explained in Chapter Three, one of the main "Islamic securitisations" structures is based on the sale and leaseback structure.

Furthermore, another technique which is worth considering is the *conventional* leasing. Again this is different from secured transactions and it has a different risk and reward structure.[276] Under this structure, the financier/lessor obtains the assets according to the lessee's specifications and put them at the disposal of the lessee. The lessee pays in return regular payments to the financier. Islamic financiers have developed a similar technique namely the *ijara* which is exactly the same with the difference that the financier bears some risks being the lessor. The *ijara* has been used in many Islamic financing transactions. Another form of *conventional* leasing is the hire purchase structure which entitles the lessee at the end of the lease to purchase the assets for a nominal sum.[277] Again, Islamic financiers have developed a similar structure namely the *ijara wa-iqtina* where there is a commitment from the debtor to buy the assets at the end of the rental period.

The above "Islamic finance" techniques do provide an alternative *means* of financing that comply with the Islamic *Shari'a*; but do provide also a "*quasi-*security" function in a manner similar to their conventional "title finance" counterparts. That may explain the development of "Islamic finance" in a country such as Saudi Arabia. Thus, since there are tensions created as a result of the interaction between the conventional finance component and the paramount legal system of Islamic *Shari'a*; "Islamic finance" comes to provide a *means* of financing and hence; the growing "Islamic finance" component in Saudi Arabia.

[275] Foster, *supra* note 111, at 147.
[276] DALHUISEN, *supra* note 211, at pp 857- 858.
[277] WOOD, *supra* note 212, at 8. For a good study on "hire-purchase" under English law *see* GOODE, *supra* note 113, Chapter 27.

5.3 FINAL OBSERVATIONS

This Section has attempted to highlight to the reader certain efforts that have been undertaken in the legal and financial industries in Saudi Arabia. The discussion shows that the Saudi conventional finance component is searching for structures that would facilitate its financing transactions. The development of the "*rahn adl*" structure as a collective security arrangement highlights this tendency. However, the Saudi secured transactions law that surrounds the conventional finance component in Saudi Arabia remains as a constraint to its activities. Even procedural rules relating to the registration of security at the Saudi Public Notaries are not clear in relation to the Saudi conventional finance component.

As a result, as argued in this Section, the development of the "Islamic finance" component in Saudi Arabia is attributed to the "legal unrests" that have resulted from the interaction between the conventional finance component and the Saudi secured transactions law. Market players have been using the "Islamic finance" techniques which have offered some form of security. These techniques are based on different basis of risk and reward and hence; different approach towards security collateral. Having said that, the above discussion in this Section has provided a snapshot of the consequences of the Saudi *existing de facto duality* as it pertains to secured transactions law.

6. CONCLUSION

This Chapter aimed at analysing the Saudi secured transactions law in the light of the *existing de facto duality*. It argued that in attempting to establish a market-led financial system, the *exiting de facto duality* in Saudi Arabia can be seen as a hurdle to achieve such result. Thus, the interaction between the Saudi conventional finance component and the Saudi secured transactions law is creating "legal unrests" that render all the attempts to create a well-developed market-led financial system fruitless.

The Chapter has also showed that in attempting to circumvent these "legal unrests", the legal and financial communities have developed certain structures such as the "*rahn adl*" structure to circumvent obstacles in the Saudi secured transactions law. Furthermore, the author perceived the development of the "Islamic finance" component in Saudi Arabia as a reaction to the difficulties created by the *existing de facto duality*. Thus, the difficulties in obtaining security collateral by the conventional finance component; may have stimulated other functional equivalence structures based on "Islamic finance" related principles to obtain the credit needed and to avoid the thorny issues resulting from the interaction between the conventional finance component and Islamic *Shari'a*

However, the *status quo* in Saudi Arabia remains unsatisfactory. Thus, the conventional finance component remains functioning and lacks a predictable and certain secured transactions law. Likewise, the "Islamic finance" component is functioning and lacking a definitive legal framework. It is perhaps desirable to modify the exiting "legal chaos" in order to produce a legal infrastructure that can accommodate both the conventional finance component and the "Islamic finance" component and; hence, creating a well-developed, rule-based and "rule of law" oriented market-led financial system.

In doing so, the author proposes a combination approach, which is discussed further in Chapter Five of this volume. The "combination approach" in Saudi Arabia involves developing the Saudi conventional finance component alongside the

"Islamic finance" component. The conventional finance component is *segregated* from the paramount legal system of Islamic *Shari'a* in the light of the DIFC model. At the same time, developing a legal framework for the "Islamic finance" component.

Applying the "combination approach" in the area of secured transactions would mean further introducing security collateral laws to serve the conventional finance component and which is segregated from the overall legal system. A law in the form of the CRL discussed above with certain modifications to accommodate the necessities of a market-led financial system would be sufficient. A part of this reform could involve introducing the concept of trust to allow for collective security arrangements to be structured easily. A good example for Saudi Arabia would be, the DIFC model and Bahrain which have recently introduced trust laws as will be seen in Chapter Five. However, for a secured transaction law to be effective there will need to be satisfactory dispute mechanisms for secured transaction disputes and modern insolvency law.[278] In addition, parallel to the development of the conventional finance component and its secured transactions law, the "Islamic finance" component needs further enhancement to facilitate structuring Islamic-compliant transactions. The enhancement of both components is in line with the Saudi aim in tying its financial market both internationally and regionally.

[278] These issues are outside the scope of this volume.

CHAPTER FIVE

CONCLUSION: A POSSIBLE SOLUTION – THE "ROAD MAP" FOR FURTHER 'DUALISING' THE SAUDI FINANCIAL LEGAL SYSTEM*

CHAPTER OUTLINE

* In connection with the author's doctoral research, the theme of this Chapter has been published with the doctoral supervisor's permission. *See* Amr Marar, *Building Dual Financial Systems,* 10 ISLAMIC BANKING AND FINANCE 18, (2006).

1. INTRODUCTION

In studying the Saudi financial and legal systems, this volume has provided a systematic insight into the legal complications that arise from the *existing de facto duality* in Saudi Arabia. It has identified the Saudi dilemma being the "legal unrests" that have resulted from the interaction between Islamic *Shari'a* and global economy trends. This interaction is the result of "state legal pluralism" which the author has discussed earlier in this volume. That is, the existence of the Saudi conventional finance component within the Islamic *Shari'a*. This existing Saudi conventional finance component is interacting with the Islamic *Shari'a* in a conflicting manner. Hence, the *exiting de facto duality* is the result of this interaction or this "*conflicting* state legal pluralism".

This conflicting form of duality has adverse implications on financial transactions such as securitisations and secured transactions. The volume has also argued that "Islamic finance" has penetrated to the Saudi financial system to provide a functional equivalent of finance that complies with the Islamic *Shari'a* and hence avoiding the "legal unrests" created by the interaction between Islamic *Shari'a* and modern finance. As argued in this Chapter, the "Islamic finance" component can be used as a *means* to modify the *exiting de facto duality* and to create another form of duality based on a "*non-conflicting* state legal pluralism".

However, prior to describing this modified form of duality; it is helpful to summarise the desired result we need to achieve. In line with the policies discussed in Chapter One and the Saudi economic policies discussed in Chapter Two, it seems that the main objective is to establish a *rule-based* market-led financial system that functions with "rule of law" components being certainty and predictability. Such, as argued in this volume, is absent from the current Saudi financial system. In order to achieve the desired objective, Saudi Arabia is advised to eliminate, to the extent possible, the interaction between its conventional finance component and the Islamic *Shari'a*. Then, Saudi Arabia can develop its "Islamic finance" component to function *alongside* its conventional counterpart.

This process, as the author of this volume perceives it, is simply a process of further *'dualising'* the Saudi financial and legal systems. Thus, the *existing de facto duality* is there because there is an interaction between conventional finance and Islamic *Shari'a*. In modifying the *existing de facto duality*, the conventional finance component is detached from the realm of Islamic *Shari'a* and the Islamic finance component will be further enhanced. The final product would be a strong Islamic financial system *alongside* its conventional counterpart (*i.e.*, a system *alongside* a system). This, it is hoped, would serve creating a robust and efficient dual financial system, which meets the requirements of a market-based economy.

At this stage, therefore, it is helpful to explore the available sources that would serve as viable models for Saudi Arabia to further achieve this *new modified duality* in the financial system and to be guided by these models throughout the financial sector law reform. So, the *new modified duality* is based on the "combination" approach (*i.e.* 'three-dimension approach' and DIFC model). Firstly, Saudi Arabia will develop its "Islamic finance" component. In doing so, Saudi Arabia can follow a "three-dimension" approach which includes international, regional and national examples.

At the international level, Saudi Arabia should be guided by the standards and the work of the major International Islamic Financial Institutions and Standard Setters (IIFISS).[1] At the regional level, Saudi Arabia should examine models that have developed in the neighbouring countries of the G.C.C such as in Bahrain. In addition, Saudi Arabia may consider examining other countries that have developed a dual financial system successfully such as in Malaysia.

Having developed its "Islamic finance" component, Saudi Arabia would need to further enhance its financial system. Since Saudi Arabia is not willing to fully "Islamise" its financial system; the conventional finance component needs further legal enhancement in order to function effectively. Hence, incorporating the "segregation" phenomenon that has been used in the Dubai International Financial Centre (DIFC) is may be desirable to eliminate any possible conflicts. This means the enactment of carefully drafted financial-related laws that are *segregated* from the overall legal system of Islamic *Shari'a*.

As discussed in Chapter One, however, a whole transplantation of a legal model is not really recommended. Saudi Arabia is advised to take into consideration the *sui*

[1] The "International Islamic Financial Institutions and Standard Setters" (hereinafter IIFISS) refer to those multilateral Islamic institutions that aim to produce regulatory and legal infrastructures for the Islamic finance industry as discussed *infra*. However, random references to Islamic financial institutions (in lower case) refer to those institutions that provide Islamic-compliant products such as Islamic banks and Islamic insurance companies.

generis nature of its legal, political and economic conditions. Hence, Saudi Arabia should commit to prepare a strong cadre that undertakes further analysis of the *status quo* in Saudi Arabia in all fields and to examine other models to gain the "know-how". This Chapter, however, provides a "road map" for the proposed financial sector law reform in Saudi Arabia. The Chapter is divided into two main parts. The first part considers the "three-dimension" approach that Saudi Arabia is advised to following in developing its "Islamic finance" component. The second part introduces the "segregation" phenomenon that has been adopted in the DIFC. The Chapter will then consider what this would mean for a country such as Saudi Arabia.

2. DEVELOPING THE "ISLAMIC FINANCE" COMPONENT: THE 'THREE-DIMENSION' APPROACH

The first stage of the proposed Saudi financial sector law reform involves developing the "Islamic finance" component of the Saudi financial system through providing a viable legal framework for the Saudi "Islamic finance" practice. In pursuing this aim, legal policymakers in Saudi Arabia are advised to take into consideration a 'three-dimension' reform approach. This 'three-dimension' approach comprises international, regional and national dimensions.

These dimensions reflect the efforts of private organisations as well as other government initiatives to develop the Islamic finance industry. Saudi Arabia, in reforming its financial system, is advised to give these initiatives due consideration for variety of reasons. Firstly, there is a growing tendency towards international co-operation in relation to the development of both conventional and Islamic financial markets.[2] Hence, Saudi Arabia should not isolate itself from this growing global trend. Secondly, Saudi Arabia is advised to conduct consultations with other Member States of the G.C.C to avoid any inconsistency with the general policies or laws of the G.C.C. This would undermine the successful establishment of unified monetary and financial systems. Finally, other models implemented at the national level should also be taken into consideration to transfer the "know-how". In this sense, Saudi Arabia can learn from other models' experiences.

2.1 THE INTERNATIONAL DIMENSION: THE ISLAMIC FINANCIAL ARCHITECTURE

The international dimension of the reform is reflected by the emerging concept of the Islamic Financial Architecture (IFA). Recently, reference to the IFA began to appear in the Islamic banking and finance literature.[3] The use of the term "architecture" in the financial context refer to the existence of a web of standards and principles of financial law and policies promulgated by the different International Financial Organisations as well as other standard-setting bodies.[4] Islamic finance commentators have been referring to the emerging IFA in a similar context.

The emerging IFA reflects the efforts by the IIFISS to build an Islamic financial market as well as to unify the practices of the Islamic finance industry. These institutions include: the Islamic Development Bank, the Accounting and Auditing Organisation for Islamic Financial Institutions, the Islamic Financial Services Board, The Organisation of Islamic Conference, the General Council for Islamic Banks and

---

[2] The international co-operation in conventional financial systems is highlighted by the growing international financial architecture mentioned in Chapter One. Similarly, as will be discussed below, an Islamic international financial architecture is emerging.

[3] Ahmad Mohamed, *The Emerging Islamic Financial Architecture: The Way Ahead, in* THE PROC EEDINGS OF THE FIFTH HARVARD UNIVERSITY FORUM ON ISLAMIC FINANCE (2002), 159 (Centre for Middle Eastern Studies-Harvard University, 2002,)[hereinafter FIFTH HARVARD FORUM]. *See also*, Mushtak Parker, *IFSB Designs for Islamic Financial Architecture*, 82 /83 ISLAMIC BANKER 8, (2002).

[4] JOSEPH NORTON, FINANCIAL SECTOR LAW REFORM IN EMERGING ECONOMICS, at 43 (2000, BIICL). Andrew Sheng, *The New International Architecture: Is There a Workable Solution, in* INTERNATIONAL FINANCIAL SECTOR REFORM: STANDARD SETTING AND INFRASTRUCTURE DEVELOPMENT, 3, at 4-5 (S. Goo et al. eds, Kluwer Law International, 2002).

Financial Institutions, the Liquidity Management Centre, the International Islamic Financial Market, the International Islamic Rating Agency and the International Islamic Centre for Reconciliation and Commercial Arbitration. The following is a brief of each of these institutions.

2.1.1 THE ISLAMIC DEVELOPMENT BANK GROUP

The Islamic Development Bank Group (IDB Group) is a multilateral financing institution comprising four entities: the Islamic Development Bank (IDB), the Islamic Research and Training Institute (IRTI), the Islamic Corporation for the Development of the Private Sector (ICD), and the Islamic Corporation for the Insurance of Investment and Export Credit (ICIEC).[5] The Group's headquarters is in Saudi Arabia with representative offices in other Islamic countries. Three conditions must be fulfilled by any country wishes to be a member in the IDB Group; these are: "membership of the Organisation of the Islamic Conference, payment of its contribution to the capital of the entity and acceptance of the terms and conditions that maybe decided upon by the entity's Board of Governors".[6]

The IDB Group was established to play a leading role in fostering socio-economic development in member countries and Muslim communities in conformity with the Islamic *Shari'a*. It aims to promote for Islamic financial industry and institutions, to alleviate poverty and to promote for the co-operation among member countries. The main IDB Group's institution is the IDB, which was established in pursuance of the Declaration of Intent issued at the Conference of Finance Ministers of Muslim Countries, held in Jeddah, Saudi Arabia in 1973 and began its operations

[5] *See 'Islamic Development Bank Group in Brief'*, (2005), at 1 *available at* http://www.isdb.org
[6] *Id.* at 2.

in 1975.[7] In line with the general aims of the IDB Group, the IDB provides financing in the form of project finance to member countries. Also, other funds were established for specific purposes.[8]

The IDB has been playing an important role in further developing the Islamic finance industry. Thus, the IDB has developed new Islamic financial modes for financing development projects in both public and private sectors.[9] Also, the IDB assisted in establishing other Islamic financial organisations and bodies, which will be discussed below, to enhance the regulatory framework and standardisation of the Islamic finance industry. In addition, the IDB is co-operating with the major international financial institutions such as the International Monetary Fund and the World Bank to ensure that "Islamic finance" is recognised within the mainstream of global economy. For example, in collaboration with the IMF, the IDB has been working on the development of internationally acceptable regulatory standards.[10] These efforts led to the establishment of the Islamic Financial Services Board.[11] Also, the IDB signed an agreement with the World Bank aiming for more strategic co-ordination between the two institutions in operational areas.[12]

In 1981, the IRTI was established to undertake research activities in the field of Islamic banking, finance and economics. The IRTI organises conferences, seminars

---

[7] *Id.* at 3.
[8] *Id.*, at 4 (the IDB established several funds such as the Islamic Banks Portfolio for Investment and Development (IBP) which is a trust fund established to mobilise the liquid funds of the Islamic banks and to channel them for promoting trade and development in member countries, in accordance with the principles of Islamic *Shari'a*. Also, the Unit Investment Fund, which was established with the aim to mobilise resources for the IDB and to earn adequate return on investment for its unit holders).
[9] Ahmed Ali, *Set Standards for Islamic Banks, Says IDB*, 57 ISLAMIC BANKER 6, at 6, (2000).
[10] *Id.*
[11] *See infra.*
[12] Ali, *supra* note 9, at 6 (operational areas such as co-financing and country technical assistance; on operational policies and technical assistance by the IDB). *See* S.A. MEENAI, THE ISLAMIC DEVELOPMENT BANK: A CASE STUDY OF ISLAMIC CO-OPERATION, chapters 11 & 14 (Kegan Paul International, 1989). *See also,* interview with IDB President Dr. A Ali, *IDB Keen on Greater Links with World Bank/IMF*, 57 ISLAMIC BANKER 7, (2000)

and generate publications including a bi-annual journal, namely; the "Islamic Economic Studies".[13] In 1994, the ICIEC was established to encourage trade transactions and flow of investments among member countries. In pursuing this aim, the ICIEC has developed an Islamic *Shari'a* compliant export credit insurance, investment insurance and reinsurance to cover commercial and country related risks.[14] Finally, in 1999; the ICD[15] was established to promote the development of the private sector in the member countries. The aims *inter alia* are to mobilise additional sources to the private sector and to develop Islamic financial and capital markets.[16] So far, the IDB Group has achieved a lot in developing Islamic finance. Its efforts should be taken into consideration and its assistance should be sought in developing an Islamic financial market.

2.1.2 Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI)

The AAOIFI was established and registered in Bahrain in March 1991 as an international autonomous non-profit corporate making body.[17] The main objective of the AAOIFI is to develop accounting, auditing, governance and ethical thought relating to the activities of Islamic financial institutions taking into consideration the international standards and practices which comply with Islamic *Shari'a* rules.[18] It also aims to harmonise the accounting policies and procedures adopted by the Islamic financial institutions as well as achieving conformity in concepts and

[13] *See generally* http://www.irti.org
[14] *See generally,* http://www.iciec.com
[15] *See generally,* http://www.icd-idb.com
[16] Ali, *supra* note 9, at 6.
[17] ISLAMIC CAPITAL MARKET: REPORT OF THE ISLAMIC CAPITAL MARKET TASK FORCE OF THE INTERNATIONAL ORGANISATION OF SECURITIES COMMISSIONS, July 2004, at 41 [hereinafter ISLAMIC CAPITAL MARKET] *available at* http://www.iosco.org
[18] *See generally* http://www.aaoifi.com

applications among *Shari'a* Supervisory Boards of the Islamic financial institutions to avoid contradictions.

The main reason behind developing special accounting standards for Islamic financial institutions is because Islamic finance operations are based on different methods and structures. Hence, conventional accounting standards such as the International Accounting Standards might be insufficient to account for Islamic financial transactions.[19] So far the AAOIFI has issued financial accounting standards, auditing standards, governance standards and codes of ethics.[20] In addition, the AAOIFI has issued a Statement on the Purpose and Calculation of the Capital Adequacy Ratio for Islamic Banks.[21] In regards to the *Shari'a* principles, the AAOIFI has issued *Shari'a* standards covering various Islamic concepts as applied by Islamic banks in their financing operations.[22] The attempt to standardise *Shari'a* related standards is a positive step that would contribute towards facilitating Islamic finance operations more efficiently.

2.1.3 Islamic Financial Services Board (IFSB)

Given the special nature of the Islamic banks and their operations, the financial intermediation and allocation of resources that are achieved by the Islamic banks are based on different legal constructions as opposed to their conventional counterparts.[23] Hence, there has been a trend to develop special regulations and

---

[19] ISLAMIC CAPITAL MARKET, *supra* note 17, at 41.
[20] *See* AAOIFI, ACCOUNTING, AUDITING & GOVERNANCE STANDARDS FOR ISLAMIC FINANCIAL INSTITUTIONS (2005).
[21] *See* AAOIFI, STATEMENT ON THE PURPOSE & CALCULATION OF THE CAPITAL ADEQUACY RATION FOR ISLAMIC BANKS (1999).
[22] *See* AAOIFI , *SHARI'A* STANDARD (2005).
[23] It is a well-established principle under conventional banking and English law that the relationship between the depositor and the bank is a relationship of debtor and creditor. *See generally*
However, the concept of intermediation under Islamic banks' practice is based on different legal relationships between the customer (*i.e.,* depositor) and the Islamic bank. Intermediation is normally achieved through a *mudaraba* agreement whereby the customer provides the money/capital for

supervision standards that address the unique risks of the Islamic banks. To achieve this aim, the IFSB has been established in Kuala Lumpur in 2002.[24] The main task of the IFSB is to develop international prudential and supervisory standards and best practices for Islamic financial institutions. The IFSB will also liaise and co-operate with other standard-setting bodies in areas of monetary and financial stability.[25]

In pursing its objectives, the IFSB has recently issued and approved two documents that lay down prudential guiding principles and standards that are expected to govern Islamic financial institutions. The first document, namely; the Guiding Principles of Risk Management,[26] provides a set of guidelines for establishing and implementing effective risk management practices. The second document, the so-called Capital Adequacy Standard (CAS),[27] aims to identify and to address specific *Shari'a* compliant products and services that are not addressed by the international capital adequacy standards. The CAS also aims to standardise the approach in identifying and measuring risks in *Shari'a* compliant products and services and in assigning risk weights thereto.[28]

However, as mentioned in Chapter One, the aim of the IIFISS has been to establish the special specificities of the Islamic financial institutions while keeping the Islamic finance industry within the mainstream of global economy. This is true in

investment with no rights of management. The Islamic bank is the *mudarib* and responsible to invest the money. Both the Islamic bank and the customer share the profit and loss and no guarantees provided by the Islamic bank on returns. Unlike demand accounts; this is the case of investment accounts where deposits are taken to be invested in project and not returnable on demand. Such contract does not create a creditor-debtor relationship; and the customer is considered as a participant in equity. *See* Chapter One on the *mudaraba* contract.

[24] *See generally* http://www.ifsb.org

[25] *Id., (*objectives of the IFSB).

[26] ISLAMIC FINANCIAL SERVICES BOARD, GUIDING PRINCIPLES OF RISK MANAGEMENT FOR INSTITUTIONS (OTHER THAN INSURANCE INSTITUTIONS) OFFERING ONLY ISLAMIC FINANCIAL SERVICES, [hereinafter RISK MANAGEMENT] December (2005) *available at* http://www.ifsb.org/.

[27] ISLAMIC FINANCIAL SERVICES BOARD, CAPITAL ADEQUACY STANDARD FOR INSTITUTIONS (OTHER THAN INSURANCE INSTITUTIONS) OFFERING ONLY ISLAMIC FINANCIAL SERVICES, [hereinafter CAPITAL ADEQUACY STANDARD] December (2005) *available at* http://www.ifsb.org/.

[28] *Id.* at 1.

the case of the IFSB. Thus consider the Risk Management Guiding Principles introduced by the IFSB. It states: "Certain issues are of equal concern to all financial institutions, including [Islamic financial institutions]. While the Basel Committee on Banking Supervision (BCBS) has published documents setting out sound practices and principles pertaining to credit, market, liquidity and operational risks of financial institutions, the present Guiding Principles serves to complement the BCBS's guidelines in order to cater for the specificities of [Islamic financial institutions]".[29]

The CAS follows a similar approach. Thus, the introduction of the CAS clearly provides that "The proposals contained [in CAS] are primarily based on the Basel Committee on Banking Supervision's documents on the (a) International Convergence of Capital Measurement and Capital Standards: A Revised Framework, June 2004 (Basel II) and (b) Amendment to the Capital Accord to Incorporate Market Risks, January 1996 (1996 Market Risk Amendment), with the necessary modifications and adaptations to cater for the specificities and characteristics of the [*Shari'a*] compliant products and services offered by the [Islamic financial institutions]".[30]

In addition, the IFSB has recently approved a set of principles on corporate governance. The Guiding Principles on Corporate Governance,[31] which were approved in 2006, are designed to facilitate Islamic financial institutions in

[29] RISK MANAGEMENT; *supra* note 26, at 1.
[30] CAPITAL ADEQUACY STANDARD, *supra* note 27, at 1(the CAS also provides that it covers minimum capital adequacy requirements based predominantly on the standardised approach in respect of credit risk and the basic indicator approach for operational risks of the Islamic financial institutions, with respect to Pillar 1 of Basel II, and the various applicable measurement methods for market risk set out in the 1996 Market Risk Amendment. However, the CAS does not address the requirements covered by Pillar 2 (Supervisory Review Process) and Pillar 3 (Market Discipline) of Basel II as these two issues will be covered by separate standards).
[31] ISLAMIC FINANCIAL SERVICES BOARD, GUIDING PRINCIPLES ON CORPORATE GOVERNANCE FOR INSTITUTIONS OFFERING ONLY ISLAMIC FINANCIAL SERVICES (EXCLUDING ISLAMIC INSURANCE (*TAKAFUL*) INSTITUTIONS AND ISLAMIC MUTUAL FUNDS), December (2006) *available at* http://www.ifsb.org/.

identifying areas where appropriate governance structures and processes are required, and to recommend best practices in addressing these issues.[32] The IFSB has also published a document governing issues related to the regulation and supervision of the Islamic insurance industry (*i.e., takaful*).[33] Having done so, the IFSB has been working again in collaboration with the International Association of Insurance Supervisors in producing this document, a fact that highlights again the IIFISS's approach in keeping within the mainstream of global economy.

The IFSB normally publishes exposure drafts and seek consultations prior to any approval. As of December 2006, the IFSB has two outstanding exposure drafts that are awaiting final approvals. These are: 1) an exposure draft on disclosure to promote transparency and market discipline[34] and; 2) a guidance on key elements in the supervisory review process for authorities that are supervising Islamic financial institutions.[35] The IFSB is also engaged in awareness programmes through organising workshops, seminars and conferences that tackle key issues in the Islamic finance industry.

Moreover, the IFSB established task forces to examine the possibility of further developing the Islamic finance industry infrastructure. For example, the Money Market Task Force was established with the view to facilitate the development of Islamic money markets and "to encourage and assist their integration into the national

---

[32] *Id.* at 1.

[33] ISLAMIC FINANCIAL SERVICES BOARD, ISSUES IN REGULATION AND SUPERVISION OF TAKAFUL (ISLAMIC INSURANCE), August (2006) *available at* http://www.ifsb.org/.

[34] ISLAMIC FINANCIAL SERVICES BOARD, EXPOSURE DRAFT NO. 4 DISCLOSURES TO PROMOTE TRANSPARENCY AND MARKET DISCIPLINE FOR INSTITUTIONS OFFERING ISLAMIC FINANCIAL SERVICES (EXCLUDING INSURANCE (TAKAFUL) INSTITUTIONS AND ISLAMIC MUTUAL FUNDS), December (2006) *available at* http://www.ifsb.org/.

[35] ISLAMIC FINANCIAL SERVICES BOARD, EXPOSURE DRAFT NO. 5 GUIDANCE ON KEY ELEMENTS IN THE SUPERVISORY REVIEW PROCESS OF INSTITUTIONS OFFERING ISLAMIC FINANCIAL SERVICES (EXCLUDING INSURANCE (TAKAFUL) INSTITUTIONS AND ISLAMIC MUTUAL FUNDS), December (2006) *available at* http://www.ifsb.org/.

financial systems and eventually into the broader international system".[36] Finally, the IFSB in co-operation with IDB have introduced a draft of the Islamic Financial Services Industry Ten-Year Master Plan (2006-2015) (Ten-Year Master Plan), which identifies the key issues that need to be addressed to further enhance the Islamic finance industry.[37]

2.1.4 THE ORGANISATION OF ISLAMIC CONFERENCE (OIS)

The OIC was established in 1969 as an inter-governmental organisation grouping fifty-six states.[38] The OIC aims *inter alia* to strengthen the Islamic solidarity among Member States as well as the co-operation in the political, economic, social, cultural and scientific fields.[39] A subsidiary organ of the OIS is the Islamic *Fiqh* Academy (Islamic Academy)[40] which was established in 1981 and based in Saudi Arabia. The membership of the Islamic Academy includes scholars and intellectuals in all fields. The Islamic Academy is expected to examine contemporary life problems with the purpose of providing solutions based on "Islamic culture and open forward looking Islamic thought".[41]

However, in co-ordination with the IDB; the Islamic Academy has set up a special committee for financial and economic matters. The committee comprises

---

[36] Islamic Financial Services Board, *Islamic Money Market Task Force (Money Market Task Force)*, IFSB Member Update, (2006), [hereinafter *Money Market Task Force*] available *at* http://www.ifsb.org/.

[37] ISLAMIC RESEARCH AND TRAINING INSTITUTE – IDB AND ISLAMIC FINANCIAL SERVICES BOARD, THE ISLAMIC FINANCIAL SERVICES INDUSTRY TEN-YEAR MASTER PLAN (2006-2015): A FRAMEWORK (DRAFT FOR DISCUSSION ONLY), (2006) [hereinafter TEN-YEAR MASTER PLAN] *available at* http://www.sbp.org.pk/. In addition, the Drafting Committee is in the process of considering comments from regulators and market players on the TEN-YEAR MASTER PLAN that have been received on 29 November 2006. *See Money Market Task Force*; *supra* note 36, at 2. The author is not aware of a final approval yet. However, discussions related to this TEN-YEAR MASTER PLAN are based on a draft prior to its approval.

[38] *See generally* http://www.oic-oci.org

[39] Article II (A), CHARTER OF THE ISLAMIC ORGANISATION OF THE ISLAMIC CONFERENCE, (1974) *available at* http://www.oic-oci.org

[40] *See generally* http://www.fiqhacademy.org

[41] *Id.*

Islamic *Shari'a* scholars as well as economic and financial experts. Their task is to examine developing issues related to economic and financial transactions. The committee has already looked at number of banking and financial related issues. The Islamic Academy has become one of the most important institutions in the Islamic finance industry. Its importance is due to the fact that the Academy has been prepared to consider sophisticated securitisation transactions and endeavour to provide novel Islamic *Shari'a* based solutions.[42]

2.1.5 General Council for Islamic Banks and Financial Institutions

The General Council for Islamic Banks and Financial Institutions (GCIBFI) was founded in Bahrain in 2001 as a non-profit making organisation.[43] The GCIBFI's mission is to "work for the support of the Islamic banking industry with a view to promoting it through the dissemination of appropriate information and accurate data".[44] The following provides a summary of the GCIBFI's objectives:[45]

1. To inform the public regarding the concepts and rules governing Islamic banking and finance practices.
2. To enhance co-operation between the members of the council and other related institutions, such as regulatory bodies, in order to achieve common objectives.
3. To prepare and disseminate information and data pertinent to Islamic banking practices.

---

[42] *See generally* ISLAMIC DEVELOPMENT BANK AND ISLAMIC *FIQH* ACADEMY, RESOLUTIONS AND RECOMMENDATIONS OF THE COUNCIL OF THE ISLAMIC FIQH ACADEMY (1985-2000), (2000) *available at* http://www.isdb.org/
[43] *See generally* http://www.islamicfi.com/
[44] BAHRAIN MONETARY AGENCY, ISLAMIC BANKING AND FINANCE IN THE KINGDOM OF BAHRAIN, [hereinafter ISLAMIC BANKING IN BAHRAIN] (Bahrain Monetary Agency, 2002) at 94 *available at* http://www.bma.gov.bh
[45] *Id.*

4. To help the members face the challenges and problems in a collective manner, in order to pave the way for success.

2.1.6 THE LIQUIDITY MANAGEMENT CENTRE (LMC)

The Liquidity Management Centre (LMC) which is based in Bahrain was established in 2002.[46] LMC facilitates the creation of an Islamic inter-bank money market and for the creation of a larger International Islamic Financial Market discussed below. The main reason for the establishment of the LMC is to offer Islamic banks an opportunity for liquidity management. The LMC was created to address two constraints that affecting the Islamic financial industry; namely, the lack of both quality assets and secondary markets.[47]

Prior to the establishment of the LMC; Islamic financial institutions had difficulty in making long-term investments due to the inability in managing their asset-liability maturity mismatch.[48] Through the LMC Islamic financial institutions would be able to manage their assets liability mismatch in accordance with the *Shari'a* principles.[49] Also, the LMC facilitates the creation of a secondary market through which Islamic financial institutions would be able to securitise their pooled assets through the issuance of tradable instruments or *sukuk*.[50]

2.1.7 THE INTERNATIONAL ISLAMIC FINANCIAL MARKET (IIFM)

The International Islamic Financial Market (IIFM) is an independent non-profit international organisation established in Bahrain and it became operational in 2002.[51] The principal objective of the IIFM is to develop an active international financial

[46] *See generally* http://www.lmcbahrain.com/
[47] ISLAMIC BANKING IN BAHRAIN, *supra* note 44 at 79.
[48] *Id.* at 80.
[49] *Id.* at 79.
[50] *See* Chapter Three on *sukuk*.
[51] *See generally* http://www.iifm.net

market based on *Shari'a* principles. The founding members of the IIFM are: the IDB, the Central Bank of Bahrain,[52] Labuan Offshore Financial Services Authority,[53] Bank of Sudan,[54] Bank of Indonesia[55] and the Ministry of Finance Brunei Darussalam.[56]

The IIFM seeks to develop a vital infrastructure for the expansion of Islamic money and capital markets both primary and secondary. The IIFM is working with the Bahrain Stock Exchange and Malaysian International Financial Exchange to facilitate cross-border listing of *Shari'a* compatible instruments.[57] Currently, the IIFM is working on Islamic instruments contract standardisation and have played a significant role in producing the first draft of Islamic Financial Services Industry Ten-Year Master Plan (2006-2015) produced by the IDB and IFSB.[58] In order to develop a successful market there is a need for a large number of players.[59] Accordingly, The IIFM is targeting new members especially the members of the International Organisation of Securities Commissions (IOSCO).[60]

Moreover, in line with the general approach of the IIFISS; the IIFM is working in co-operation with conventional finance institutions to ensure keeping its progress within the mainstream of global economy. Thus, the IIFM and the International

[52] The title "Central Bank of Bahrain" replaces the "Bahrain Monetary Agency" which was the official name for the central bank in Bahrain in accordance with DECREE NO. 26 OF 2006 WITH RESPECT TO PROMULGATING THE CENTRAL BANK OF BAHRAIN AND FINANCIAL INSTITUTIONS LAW). *See also* THE CENTRAL BANK OF BAHRAIN AND FINANCIAL INSTITUTIONS LAW [hereinafter CENTRAL BANK OF BAHRAIN LAW] *available at* http://www.bma.gov.bh
[53] *See generally* http://www.lofsa.gov.my
[54] *See generally* http://www.bankofsudan.org
[55] *See generally* http://www.bi.go.id
[56] *See generally* http://www.finance.gov.bn
[57] Interview with Ijlal Ali, *IIFM in New and Active Mode*, 10 ISLAMIC FIN. REV 4, at 4, (2005).
[58] *Id.*
[59] *See* ISLAMIC BANKING IN BAHRAIN, *supra* note 44, at 81-82 (there are three main factors in order for IIFM to be successful: the involvement of large number of players, the creation of a wide range of Islamic financial instruments and availability of an adequate liquidity in the market).
[60] *IIFM Admits Six New Members*, 7 ISLAMIC FIN. REV. 5, at 5 (2004).

Swaps and Derivatives Association (ISDA)[61] have signed a memorandum of understanding as a basis for developing a master agreement documenting privately negotiated *Shari'a* compliant derivatives transactions.[62] All these efforts would contribute towards further enhancing the Islamic finance industry.

2.1.8 THE INTERNATIONAL ISLAMIC RATING AGENCY (IIRA)

In order to increase the transparency and to provide confidence to the investors and to the regulators alike; the International Islamic Rating Agency (IIRA) was incorporated in Bahrain in 2002.[63] Like other conventional rating agencies; the IIRA aims to provide external rating system to improve the availability of information. The objectives of IIRA *inter alia* include the following:[64]

1. to carry on the business of research, analysis, rating, evaluation and appraisal of the obligations, dues, commitments, shares, stocks and other securities issues;
2. to provide an independent assessment and opinion on the likelihood of future loss of a rated entity or a financial instrument; and
3. to provide an independent assessment of compliance by the rated entity or financial instrument applying the principles of *Shari'a*.

However, because Islamic finance transactions must be *Shari'a* compliant, the IIRA has developed the Methodology for *Shari'a* Quality Rating.[65] Unlike credit rating, a *Shari'a* Quality Rating (SQR) does not relate to the financial capability of the institution or the credit quality of the securities. Rather it is concerned with

[61] *See generally* http://www.isda.org/
[62] *See* International Islamic Financial Market, *ISDA and IIFM agree to develop documentation for Shari'ah compliant derivatives*, 12 September (2006) and *Standardising Derivatives for Islam*, 16 November (2006) *available at* http://www.iifm.net.
[63] *See generally* http://www.iirating.com/
[64] *Id.*
[65] INTERNATIONAL ISLAMIC RATING AGENCY, METHODOLOGY FOR *SHARI'A* QUALITY RATING *available at* http://www.iirating.com/.

issuing an independent opinion about the *Shari'a* quality of the institution or the issued securities.[66] The IIRA has also developed the Corporate Governance Rating Methodology.[67] The IIRA's Corporate Governance Rating is an independent opinion on the organisation's commitment to excellence in its managerial practices.[68]

2.1.9 THE INTERNATIONAL ISLAMIC CENTRE FOR RECONCILIATION AND COMMERCIAL ARBITRATION (IICRCA)

The IICRCA is a recent project launched in Dubai on 9 April 2005.[69] The aim of the IICRCA is to provide a platform to settle financial and commercial disputes between Islamic financial institutions; and between these institutions and third parties through reconciliation and arbitration.[70] The secretary-general of the GCIBFI explained that settling the disputes of the Islamic financial institutions is costly due to the absence of an institution offering alternative dispute services specifically to Islamic financial institutions.[71] To facilitate the dispute settlement process related to the Islamic finance activities, the IICRCA was established and supported by the IDB and the UAE.[72] The IICRCA's Board of the Trustees held a meeting in June 2005 to discuss several amendments to the IICRCA's bylaws that are pending ratification.[73] During the meeting, the members of the executive committee were appointed and other issues were discussed including the budget for the first year.[74] The

[66] *Id.* at 1 (the IIRA has the following rating: AAA(SQR), AA(SQR), A(SQR), BBB(SQR), BB(SQR and B(SQR).
[67] INTERNATIONAL ISLAMIC RATING AGENCY, CORPORATE GOVERNANCE RATING METHODOLOGY, *available at* http://www.iirating.com/.
[68] *Id.* at 1.
[69] *New Centre in Dubai to Settle Islamic Financial Disputes*, (10/4/2005) *available at* http://www.islamicfi.com
[70] *Id.*
[71] *Id.*
[72] *Id.* (the IDB has contributed about half of the investment and the remaining amount was provided by the UAE).
[73] *UAE Elected to Preside over International Islamic Commercial and Arbitration Centre* , (7/6/2005) *available at* http://www.ameinfo.com
[74] *Id.*

establishment of the IICRCA plays an important role in further enhancing the Islamic finance industry.[75]

2.1.10 FINAL OBSERVATIONS: IFA AS A SOFT LAW

The above discussion reflects the growing tendency towards the institutionalisation of "Islamic finance" through the establishment of the IIFISS. Also, IIFISS are contributing in the development of an IFA facilitating in turn the activities of "Islamic finance". Arguably, however, the "voluntary adoption" nature of theses standards is the main challenge for their implementation. The editorial of the Islamic Banker writes:

> "... the operative phrase in the terminology of establishment is that [the IFSB] standards and core principles will be "for voluntary adoption by member countries". This could turn out to be the Achilles Heel of the IFSB...We have been down this route of "voluntary adoption" of standards in Islamic finance sector before. And it has yet to deliver.
>
> ...AAOIFI, for instance, has issued various standards ad an accounting framework for Islamic banks. Only one central bank, the host [Bahrain Monetary Agency] has translated this into law requiring all Islamic financial institutions incorporated in Bahrain to reports its financial statements both according to the International Accounting Standards and according to the AAOIFI standards...
>
> ...Therefore, the IFSB needs to have some teeth to persuade founder members and other who are invited to join later, that once a standard or set of core principles are agreed, then they should be adopted by all member"[76]

From a legal perspective; the above statement would suggest that the standards issued by the IIFISS can be considered as a 'soft law' or as legally non-biding rules.

[75] The author is not aware of when the IICRCA will be fully functional.
[76] Editorial, *Voluntary Adoption Challenge for IFSB*, 80 ISLAMIC BANKER 2, at 2, (2002).

Unlike 'hard law', 'soft law' does not imply obligation,[77] and it can be defined to mean a " norm expressed by the international community to which it is hoped at least by a group of states articulating the 'norm', that states will adhere, but to which there is no obligation of adherence".[78] This means that these "Islamic finance" related standards are not legally binding and are mere policy recommendations of the IIFISS.[79] Arguably, for 'soft law' standards to be effective and fulfil their functions; they should be implemented at the national level and be transformed into laws or 'hard law'.[80] Such standards can then be legally binding once have been transformed into domestic law.[81] The Kingdom of Bahrain, for example, requires Islamic banks to apply certain AAOIFI standards.

However, the IIFISS are aware of the challenge facing the implementation of the "Islamic finance" related standards as well as developing a viable legal infrastructure for the "Islamic finance" activity at the national level. Thus, the Islamic Financial Services Industry Ten-Year Master Plan (2006-2015),[82] that has been prepared by the IFSB and the IDB raises these issues. It states in general terms "Islamic finance is

[77] Cynthia Lichtenstein, *Hard Law v Soft Law: Unnecessary Dichotomy?, in* INTERNATIONAL MONETARY AND FINANCIAL LAW UPON ENTERING THE NEW MILLENNIUM, at 355, 355 (Joseph Norton et al., eds., BIICL, 2003).
[78] *Id.* 356.
[79] Giovanoli referring to the conventional financial standards but it can also apply to the Islamic standards. *See* Mario Giovanoli, *A New Architecture for the Global Financial Market: Legal Aspects of International Financial Standard Setting, in* INTERNATIONAL MONETARY LAW: ISSUES FOR THE NEW MILLENNIUM, 3, at 34 (Mario Giovanoli ed., Oxford University Press, 2000).
[80] *Id.* at 51. *Cf.* Lichtenstein, *supra* note 105, at 365 suggesting that enforcement could be achieved through the 'managerial model' described by Chayes. He summarises Chayes' thesis stating: "...compliance with international norms, whether 'hard' or 'soft', is better achieved through regulatory regimes that utilise a 'managerial model' relying on co-operative, problem solving approach than regimes presenting an 'enforcement model' with a coercive approach". *See Id.* at 362. *See also* Chayes and Chayes, *'On Compliance'*, 47 Int'l Org 175 (1993); Chayes & Chayes, The New Sovereignty: Compliance with International Regulatory Agreements (Harvard University Press, 1995); Chayes, *Managing Compliance: A Comparative Perspective, in* ENGAGING COUNTRIES, STRENGTHENING COMPLIANCE WITH INTERNATIONAL ENVIRONMENTAL ACCORDS (Brown Weiss et al. eds., 1998).
[81] *Id.* (Giovanoli also discusses other mechanisms through which such standards can be implemented; namely, 'market discipline' and 'official incentives').
[82] *See* TEN-YEAR MASTER PLAN, *supra* note 37.

still a nascent industry in most countries and has not yet achieved a critical mass or strategic focus needed for an effective recognition of its unique operational features in the national policy making process. Therefore, Islamic international infrastructure institutions can and should play a key catalytic role in promoting the industry at the national level".[83]

The Ten-Year Master Plan identifies key challenges that need to be addressed by the Islamic finance industry. These include, *inter alia,* building an appropriate legal framework and an enabling supervisory framework.[84] The Ten-Year Master Plan addresses these challenges broadly but then it gets more focused on the national level again in respect to the Islamic countries. It critically states: "... there are still many countries where legal and institutional framework is not explicit and transparent about Islamic finance, and the supervision framework for conventional finance continues to apply to Islamic banks, with some operational level variations to recognise their specific characteristics".[85]

The Ten-Year Master Plan continues stating that "significant weaknesses in legal, governance, and systemic liquidity infrastructure is impeding the spread of product innovations in Islamic finance, and preventing effective supervision and risk management". Also, the insolvency and creditor rights regimes, contract enforcement and the limited adoption of AAOIFI accounting standards for Islamic institutions in Islamic countries has been singled out as weaknesses that need to be addressed.

[83] *Id.* at 40.
[84] *Id.*
[85] *Id.*, at 35.

In addition, the Ten-Year Master Plan provides a policy strategy for Islamic countries to further develop their "Islamic finance" industry at the national level. The policy strategy includes, *inter alia,* the following elements:[86]

1. the public sector shall play an extensive catalytic role in developing role in developing *Shari'a* Governance Systems within financial institutions and regulatory organisations through an effective education and an appropriate institutional;
2. recognise more explicitly the position of Islamic finance in financial sector laws, and in supervisory regime, so that the unique operational features of Islamic finance can be recognised in the regulatory framework and an enabling environment can be provided for product innovations and enhanced access, while safeguarding stability;
3. strengthen insolvency and creditor right regime, investor protection arrangements;
4. reduce legal risks and improve legal certainty; and
5. facilitate effective enforcement of Islamic finance contracts in various legal environments.

The above policies, while still mere suggestions, reflect the IIFISS' views and their awareness of the importance of the law as an instrument to develop the Islamic finance industry. Regardless of the legal nature of these "Islamic finance" related standards and recommendations, these standards and recommendations are of great importance to Saudi Arabia in its financial sector law reform. Saudi Arabia is advised to give due consideration to these standards and recommendations in developing the

[86] *Id.*, 46 – 47.

"Islamic finance" component of its financial system and to establish bridges of communications and technical support with the IIFISS .

2.2 THE REGIONAL DIMENSION: EFFORTS BY THE G.C.C MEMBER STATES

The international dimension is not the only dimension which Saudi Arabia is advised to consider in developing its "Islamic finance" component but also the regional dimension should be given due consideration. The creation of the Gulf Co-operation Council (G.C.C) as a regional integration model;[87] and the implementation of its policies necessitate the achievement of a high level of harmonisation in all economic policies especially the fiscal and monetary policies as well as banking legislations.[88] Also, the G.C.C agreements oblige Member States to integrate financial markets among themselves and to unify all related legislation and policies.[89] As a member of the G.C.C, Saudi Arabia is influenced by these agreements and it is required, sooner or later, to adapt its laws and legislations with these policies that have been approved at the G.C.C regional level.

Despite the fact that no express indications are made in the G.C.C agreements as to the harmonisation of the Islamic banking and financing laws; the requirement that a high level of financial related laws harmonisation should be achieved at the G.C.C level would presumably encompass Islamic financial-related laws. So far no uniform financial-related laws of obligatory nature have been approved by the G.C.C.[90] Several financial-related laws of "non-obligatory" nature have been approved such

---

[87] *See* Chapter Two on the G.C.C. *See also* Amr Marar, *The Co-operation Council for the Arab States of the Gulf*, 10(3) LAW AND BUS. REV. AMER. 475, (2004).

[88] Art. 4, THE ECONOMIC AGREEMENT, 31 December 2001, *available at available at* http://www.gcc-sg.org/.

[89] *Id.* Art. 5(3).

[90] The laws and agreements enacted by the GCC fall under two categories, namely, obligatory and non-obligatory. The non-obligatory laws are enacted for guidance only.

as: the Law of the Centralisation of Risks,[91] the Unified Law on the Supervision and Monitoring of Insurance Operations in the G.C.C States[92] and the Law on Capital on Adequacy of Capital, Asset Risks, and the Law on Credit Concentrations in the G.C.C Banks.[93]

At the national level, however, Member States of the G.C.C, except of Saudi Arabia[94] have introduced either Islamic financial-related laws or special "Islamic finance" directives. The Kingdom of Bahrain, the State of Kuwait, the State of Qatar and the United Arab Emirates have all introduced "Islamic finance" related laws as well as directives that govern "Islamic finance" at the national level and have not been addressed at the regional level of the G.C.C. Despite its national effect, the existing "Islamic finance" related laws of the G.C.C Member States would possibly influence any attempt to unify "Islamic finance" related laws at the regional level and in turn Saudi Arabia. Bearing this in mind, these laws do provide a useful guidance for the Saudi legal policymakers. Hence, consultations with other G.C.C Member States is more likely to achieve positive results for the Saudi financial sector law reform. In the rest of this Section the author provides an overview of the efforts undertaken by the G.C.C Member States in relation to the "Islamic finance" related laws.

2.2.1 THE KINGDOM OF BAHRAIN

Bahrain is one of the most proactive states in Islamic finance.[95] The first Islamic bank was established in 1979 when the Bahrain Islamic bank was licensed.

[91] Approved on the Seventh Meeting of the Committee of Governors of Monetary Institutions & Central Banks; Abu Dhabi 25 -26 January 1986.
[92] Approved on 14th Meeting of the Commercial Co-operation Committee, Muscat; 26 December 1989.
[93] Approved by the Committee of Governors of Monetary Institutions and Central Banks, Abu Dhabi, 10 April 1993.
[94] Also, the Sultanate of Oman has not promulgated any Islamic financial-related laws.
[95] Rodney Wilson, *The Politics of Islamic finance*, 147 NEW HORIZON 5, at 6, (2005).

Currently, there are twenty eight Islamic banks including commercial, investment and offshore banking.[96] In doing so, Bahrain is following the current trend through further developing its "Islamic banking" and its conventional counterpart.[97] Unlike other Islamic countries, the Central Bank of Bahrain (CBB) has developed the Prudential Information and Regulatory Framework to regulate Islamic banks. The framework covers areas such as capital adequacy, asset quality, the management of investment accounts and the liquidity management.

Both Islamic and conventional banks are governed by the Rulebook[98] The Rulebook is divided into five volumes covering different areas of financial services activity, namely; conventional banks, Islamic banks, insurance, investment business and specialised activities. Volume (2) of the Rulebook is a comprehensive rulebook on Islamic banks and it contains two parts. Part (A) is the main part containing all applicable rules and guidance such as the licensing and authorisation requirements, principles of business, public disclosure requirements. Part (B) contains supporting materials such a glossary defined terms and reporting forms.

The Bahraini government also does support the issuance of Islamic *sukuk* (*i.e.* bonds). The government issues *salam* Government *Sukuk* as well as Islamic Government Leasing (*ijara*) *Sukuk* in accordance with Islamic *Shari'a* standards.[99] In doing so, Islamic banks have the opportunity to invest in governmental bonds just like conventional banks. Recently, the Bahraini government has increased the debt issuance including the issuance of Islamic *sukuk*. For example, *sukuk al-salam* of 91 days maturity has been increased from US$ 25 million to US$ 40 million.[100] Both

---

[96] *See* http://www.bma.gov.bh
[97] ISLAMIC BANKING IN BAHRAIN, *supra* note 44, at 42.
[98] *See* http://www.bma.gov.bh
[99] *Id.*
[100] Editorial, *'BMA Increases Sukuk Issuance'*, 10 ISLAMIC FIN. REV. 2, at 2, (2005).

conventional and Islamic private issuances of bonds and *sukuk* are regulated by the CBB. However, these standards do not refer specifically or define Islamic bonds.

Bahrain also has both conventional and Islamic insurance services. The Central Bank of Bahrain and Financial Institutions Law defines "Insurance or Re-insurance Company" as "any company licensed under [the law] to enter into and implement insurance, reinsurance, *Takaful* or re-*Takaful*"[101] The Rulebook contains comprehensive regulations that govern Islamic insurance and re-insurance.[102] Also, Islamic insurance companies are required to have *Shari'a* advisory boards to supervise and to direct the activities of the company.[103]

The Kingdom of Bahrain joins other Islamic countries in following the general trend in developing the Islamic finance component alongside conventional finance. Also, it has been undertaking major reforms recently in terms of its financial infrastructure. For example, it has recently enacted the Financial Trust Law[104] to facilitate financial transactions. This is a major "legal revolution" in the G.C.C Region's legal history. Yet, Bahrain is a model to other G.C.C Member States, including Saudi Arabia that can be learned from in any financial sector law reform efforts.

2.2.2 THE STATE OF KUWAIT

In Kuwait the law has been amended in 2003 to include a section on Islamic banks. Articles 86-100 of the Central Bank of Kuwait Law 32/1968 (CBKL),[105] governs Islamic banking operations. The CBKL defines Islamic banks as those that

[101] Article 1, CENTRAL BANK OF BAHRAIN LAW, *supra* note 52.
[102] *See* CENTRAL BANK OF BAHRAIN, CENTRAL BANK OF BAHRAIN RULEBOOK, Volume 3, *available at* http://www.bma.gov.bh.
[103] *Id.*
[104] LAW NO. 23 OF THE YEAR (2006) REGARDING THE REGULATION OF FINANCIAL TRUSTS, *available at* http://www.bma.gov.bh
[105] CENTRAL BANK OF KUWAIT, CENTRAL BANK OF KUWAIT LAW NO. 32 (1968) [hereinafter CBKL] (amended as per stipulations of Decree Law No. 130/1977 (25 October 1977), and Law No. 30/2003 (25 May 2003) *available at* http://www.cbk.gov.kw

"exercise the activities pertaining to banking business, and any activities considered by the Law of Commerce or by customary practice as banking activities, in compliance with the Islamic *Shari'a* principles...".[106] The CBKL requires that each Islamic bank should have an independent *Shari'a* Supervisory Board to ensure that the operations of the Islamic banks are in conformity with Islamic *Shari'a* principles.[107]

The law also recognises the nature of the Islamic banks' operations. Thus, Islamic banks are allowed to acquire buildings or to acquire by reservation of title for the purposes of executing finance operations in compliance with the Islamic *Shari'a* principles.[108] No other laws have been passed to govern other Islamic finance related services such as Islamic capital markets or Islamic insurance.

2.2.3 THE STATE OF QATAR

The state of Qatar has also joined the general trend in incorporating Islamic banking regulations within its current supervisory rules. The Central Bank of Qatar (CBQ)[109] has issued the Banking Supervision Instructions (BSI) which deals with Islamic banks.[110] However, both the BSI and the Law Establishing the CBQ[111] serve to supervise Islamic banks. The BSI defines "Islamic finance activities"[112] and requires that Islamic banks should seek the assistance of a *Shari'a* committee to

---

106 *Id.* art. 86.
107 *Id.* art. 93.
108 *Id.*, art. 99
109 *See generally* http://www.qcb.gov.qa
110 *See* CENTRAL BANK OF QATAR, BANKING SUPERVISION INSTRUCTIONS, Part VII, at 101 [hereinafter BSI] *available at* http://www.qcb.gov.qa
111 DECREE LAW NO. (15) OF THE YEAR 1993, ESTABLISHING THE QATAR CENTRAL BANK (as amended) *available at* http://www.qcb.gov.qa.
112 BSI, *supra* note 110, at 71. (defines "Islamic finance activities" as conducting all the financing business as by means of Murabaha, Musawamah, Mudarabah, diminishing participation (Musharaka), Istisna, or other Islamic financing operations, for the short, medium, or long terms financial and economic activities, whether direct or indirect by mean of the banking assemblies, or issuing bonds (Sukuk), including all types of direct or indirect financing facilities, totally or partially whether for individuals, the other financial and economic sectors. or country, including the financing of projects, foreign trade and other financing purposes).

approve the bank operations.[113] The BSI also defines certain financing operations conducted according to the Islamic *Shari'a* financing principles and divides Islamic financing into "Islamic Local Financings" and "International Islamic Financing".

The BSI also provides a specific section related to the accounting procedures and financial statements that should be produced by Islamic banks.[114] No other laws or guidelines have been issued to govern other Islamic financial related activities. However, the Qatari government has shown its commitment towards the Islamic financial services by issuing sovereign Islamic *sukuk* to finance certain projects. Qatar is also witnessing a "legal revolution". It has established recently the Qatar Financial Centre to attract foreign capital and investments. This might involve further Islamic finance related legislations.

2.2.4 THE UNITED ARAB EMIRATES

Just like other G.C.C Member States, the UAE has followed a similar approach and has adopted specific "Islamic finance" regulations that govern both Islamic and conventional banks. To this effect, the UAE has enacted a federal law to govern Islamic banks, financial Institutions and investment companies.[115] The law defines Islamic banks, financial institutions and investment companies as "those whose articles and memorandums of association include a commitment to abide by the provisions of the Islamic *Shari'a* law; and conduct their activities therewith".[116] The law requires that a *Shari'a* Supervision Authority should be formed to ensure that the transactions are according to the Islamic *Shari'a*.[117] The law also establishes a "Higher *Shari'a* Authority" attached to the Ministry of Justice and Islamic Affairs in

[113] *Id.* at 101.
[114] BSI, *supra* note 110, at 263.
[115] *See* FEDERAL LAW NO. (6) 1985 REGARDING ISLAMIC BANKS, FINANCIAL INSTITUTIONS AND INVESTMENT COMPANIES *available at* http://www.centralbank.ae/
[116] *Id.* art.1.
[117] *Id.* art.6.

order to ensure the legitimacy of the Islamic banks and their conformity with the Islamic *Shari'a*.[118]

Islamic financial institutions have the right to carry out lending, to enter any other financial operations and to receive deposits for investment in accordance with the provisions of Islamic *Shari'a*.[119] The law also exempts Islamic banks from certain prohibitions imposed on conventional banks. Thus, unlike conventional banks; Islamic banks are allowed to acquire immovable property as well as trade in goods for its account.[120] Such facilitates the activities of Islamic banks operations which normally involve trading arrangements.

In addition, the UAE has also passed regulations to govern the activities of Islamic *sukuk*. Thus, the Securities and Commodities Authority (SCA)[121] promulgated the Resolution Concerning the Listing of Islamic Bonds (the "Resolution").[122] The Resolution defines Islamic bonds as "any bonds issued in accordance with *Shari'a* principles and offered through a Public Subscription".[123] The Resolution sets out a number of conditions that Islamic bonds should fulfil including being approved by a *Shari'a* committee.[124] This again would facilitate the issuance of Islamic *sukuk* and would enhance its market.

2.2.5 Final Observations

Most of the G.C.C Member States have recognised the special characteristics of "Islamic finance". Certain Member States have passed laws and specific rules to

[118] *Id* art.5.
[119] *Id.* art. 3(2).
[120] *Id.* art. 4 (states that Islamic banks "shall be exempted from provisions of Clause (a) of Article (90) and Clause (e) of Article (96) of Uniform Law No (10) of 1980" it shall also be exempted from "provisions of Clause (b) of Article (90) of Union Law No (10)...").
[121] The Securities and Commodities Authority is the regulator of the UAE's securities market. The two main exchanges are the Abu Dhabi Securities Market (ADSM) and the Dubai Financial Market (DFM). *See generally* http://www.sca.ae/.
[122] RESOLUTION CONCERNING THE LISTING OF ISLAMIC BONDS (2005) *available at* http://www.sca.ae/
[123] *Id.* art. (1)
[124] Art. (5)

govern and regulate Islamic banks. Further, certain countries have introduced rules that govern Islamic insurance as well as Islamic *sukuk.* The development of "Islamic finance" in these countries as well as the increasing "financial awareness" seems to be the current trend. In addition, further integration among the G.C.C Member States under the G.C.C economic related agreements would definitely raise issues related to the harmonisation of their financial markets including their "Islamic finance" related regulations and rules. This might be developed further to bring about a *dual regional financial market* that includes Islamic and conventional finance.

These developments that are taking place around Saudi Arabia are of great relevance. At this stage of its development, Saudi Arabia might be interested to tap its financial system regionally and internationally. To do so at the regional level, Saudi Arabia should adhere to the G.C.C agreements and this means that developing the "Islamic finance" component should be given due consideration. Hence, Saudi Arabia can take the initiative to conduct consultations with its neighbouring countries, to analyse the effectiveness of their laws and to develop a clear agenda as to the development of its "Islamic finance" component at the national level in light of these regional developments. Otherwise, Saudi investors who are desirous to invest in compliance with the Islamic *Shari'a* might be tempted to invest outside in neighbouring G.C.C Member States which maintain "Islamic finance" friendly regulatory frameworks.

2.3 THE NATIONAL DIMENSION: THE MALAYSIAN MODEL[125]

Further to the international and the regional dimensions discussed above; Saudi Arabia is also advised in developing its "Islamic finance" component is also advised

[125] *See generally* Amr Marar & Wong Sau-Ngan, *Islamic Securities Exchanges: Principles and International Developments, in* FINANCIAL MARKETS AND EXCHANGES LAW, (Oxford University Press, 2006 – forthcoming).

to consider other models that are implemented at the national level. A successful model which certainly provides lessons that Saudi Arabia can learn from is the Malaysian model. The Malaysian experience has been always seen as a successful model which other developing countries including the Arab world can learn from and follow.[126] Malaysia has formally recognised "Islamic finance" alongside conventional finance and it is considered to be a "highly proactive" in developing and fostering "Islamic finance".[127] Hence, the Malaysian financial system has been referred to as dual. Yakcop writes: "interest-free banking in Malaysia work within a dual system where the Islamic financial system operates in parallel with the conventional financial system".[128]

The success in the implementation and overseeing a dual financial system is perhaps attributed to in Malaysian government's strong support of the "dual" policy.[129] The Malaysian government has taken essential measures to create a viable environment to accommodate such dual financial system. In doing so, the Malaysian government has followed a gradual approach which involved introducing the Islamic financial system step by step alongside its conventional counterpart rather than Islamising rapidly the conventional financial system.[130] In incorporating "Islamic finance" alongside conventional finance, Malaysia has joined other Islamic countries

[126] *See* Massoud Derhally, *Malaysia: A Model for Economic Growth*, May ARABIAN BUS. 46, (2003). *See also* Nor Yakcop, *Modelling Interest Free Financial Systems: Avoiding Costly Errors the Malaysian Way*, 16 ISLAMIC BANKER 12, at 12, (1997). *See also* Farhan Bokhari, *Model Destination for Islamic Finance?*, FINANCIAL TIMES, 2 October (2006).
[127] *See* Mushtak Parker, *Clamouring for Regulation*, 32 ISLAMIC BANKER 6, at 7, (1998) (compiling a table that shows several countries' attitude towards Islamic finance).
[128] Yakcop, *supra* note 126, at 12. *See generally* Ramin Maysami et. al., *One Country, Two Systems: Banking in Malaysia*, 13(7) JIBL 233, at 236-237, (1998).
[129] Aishah Bidin, *The Impact of Islamic Law in the Banking and Financial Market: A Malaysian Perspective*, 22(5) Company Lawyer 154, at 160, (2001).
[130] Yakcop, *supra* note 126, at 12.

in recognising and following the emerging trend of having both Islamic and conventional finance.[131]

Malaysia has also gone further and introduced the Malaysia International Islamic Financial Centre (MIFC).[132] In doing so, Malaysia is aiming to be the international Islamic financial hub. The MIFC is developed to be a "one-stop-centre" for Islamic finance, banking and *takaful*. The central bank of Malaysia, namely; Bank Negara Malaysia, has already introduced guidelines to facilitate the establishment of Islamic financial institutions in the MIFC. Having highlighted the Malaysian approach towards "Islamic finance", it is helpful to examine how Malaysia has developed "Islamic finance" at the national level.

2.3.1 ISLAMIC FINANCE IN MALAYSIA: AN OVERVIEW

The Malaysian financial system has become "dual" when the Malaysian government has decided to develop the "Islamic finance" component. In essence, introducing "Islamic finance" within the Malaysian financial system was a response to meet the necessities of the Malaysian Muslim community.[133] It is also seen as a step by the government to induce Islamic economic values in Malaysia.[134] Unlike Saudi Arabia, however, Malaysia does not maintain Islamic *Shari'a* as the paramount legal system of the country.[135] Thus, in Malaysia; Islamic *Shari'a* is confined to family law, religious revenues and charitable property.[136]

---

[131] Also the Malaysian policy in creating a dual financial system by introducing and supporting Islamic banks alongside the conventional system has been criticised on the ground that it might has gone too far in allowing too many Islamic banks and Islamic windows to function. *See* Mushtak Parker, *A Financial Market Liberalisation Too Far*, 110/111 ISLAMIC BANKER 16, (2005).

[132] *See generally* http://www.bnm.gov.my/

[133] NIK THANI ET. AL, LAW AND PRACTICE OF ISLAMIC BANKING AND FINANCE, at 11 (Sweet & Maxwell, 2003).

[134] *Id.* at 12 (referring to article 3(1) of the Federal Constitution which provides: "Islam is the religion of the Federation, but other religions may be practiced in peace and harmony in any part of the Federation").

[135] *Id.*

[136] Federal Constitution, Ninth Schedule, List II and Article 74. CHECK.

Prior to 1983, Malaysia maintained a conventional financial system. The only exception was the Pilgrims Management Fund Board which was a merger of the Pilgrims Affairs Department of the government and the Malaysian Muslim Pilgrims Savings Corporation.[137] To this effect, the Pilgrimage Management Fund Board Act (1969) was passed by the Malaysian government.[138] The operations of the Fund were in conformity with the Islamic principles. The aim of the Fund was "the utilisation of and investment of savings in connection with the protection, control and general welfare of Muslims going to pilgrimage".[139] However, the mere availability of such Fund as a saving institution was not sufficient to meet the sophisticated demands of finance according to the Islamic principles.[140]

Hence, there was a growing pressure on the government to consider establishing an Islamic bank following the experiments of Islamic banking elsewhere in the Middle East and Pakistan.[141] The pressure initiated by various entities has led to the formation of the National Steering Committee on Islamic Banking (NSCIB) in 1981. The main aims of the NSCIB were:[142]

- to study and identify various critical aspects of Islamic banking such as the basis of establishment, the areas of operations, and the business relationship with the customers and other financial institutions;

---

[137] THANI ET. AL, *supra* note 133, at 11 (also the National Bumiputra Trust was established to attract savings according to the Islamic principles).
[138] *See generally* ISLAMIC RESEARCH AND TRAINING INSTITUTE, TABUNG HAJI AS AN ISLAMIC FINANCIAL INSTITUTION, (IRTI, 1995) *available at* http://www.irtipms.org/
[139] THANI ET. AL, *supra* note 133, at 11.
[140] *Id.* at 12.
[141] *Id.* at 14 (explaining that the Bumiputra Economic Congress in 1980 issued a resolution calling the government to allow the establishment of an Islamic bank. Another resolution was passed by the National Seminar on the Concept of Development in 1981 which was held at the National University of Malaysia. The resolution called upon the government to take actions in order to allow financial institutions to operate according to Islamic principles. At the state level; the governments of the states Kelantan and Malacca issued statements to show their desire of establishing Islamic banks).
[142] THANI ET. AL, *supra* note 133, at 15.

- to examine the suitability of Islamic banking in the Malaysian context from various points of view, including the religious, legal, racial, social and development angles; and
- to present to the government a proposal to establish Bank Islam Malaysia in a complete report encompassing the following aspects - the fundamental concepts of Islamic banking, the legal framework, the structure of the company, the areas of operation and the organisational structure.

In pursuing the above aims; the NSCIB formed three technical committees: the Religious Committee, the Legal Committee and the Banking Operations Committee.[143] These committees have considered various studies undertaken on Islamic banking by several entities.[144] The committees also studied the examples of Islamic banks in Egypt and Sudan.[145]

Having undertaken its own research the NSCIB submitted a report to the government in 1982 recommending the establishment of an Islamic bank according to the principles of Islamic *Shari'a*.[146] The NSCIB also recommended the establishment of one Islamic bank because the concept of Islamic banking is new in Malaysia.[147] The NSCIB suggested that an Act should be passed to deal with licensing and supervising the newly established Islamic bank.[148] Also, a Religious Advisory Council should be set up to ensure that the operations by the Islamic bank conform to Islamic *Shari'a* principles.[149]

---

143 *Id.*
144 For example a document prepared by the International Association of Islamic Banks entitled "Model Islamic Bank".
145 Namely Fisal Bank of Egypt and Fisal Bank of Sudan.
146 THANI ET. AL, *supra* note 133, at 16.
147 *Id.*
148 *Id.* at 17.
149 *Id.*

The recommendations by the NSCIB have been accepted by the Malaysian government. The government passed the Islamic Banking Act of 1983 allowing the first Islamic bank in Malaysia to be incorporated namely; the Bank Islam Malaysia Berhad.[150] However, in realising the need to further deepen and strengthen the "Islamic finance" market alongside its conventional counterpart, the Malaysian government has taken further measures. In 1984 another law was passed allowing Islamic-compliant insurance companies (*i.e., takaful* companies) to be established in Malaysia. Similarly, special guidelines and rules have been issued to govern the operations of an Islamic capital market and the issuance of bonds.

Ten years after the establishment of the first Islamic bank in Malaysia, the government introduced a scheme whereby existing conventional banks were allowed to offer Islamic-compliant products. The scheme was known as *Skim Perbankan Tanpa Faedah* (SPTF)[151] or the Interest-Free Banking Scheme.[152] Under this scheme, conventional banks were allowed to establish an Interest-free Banking Unit (IBU).[153] This scheme was further upgraded few years later. Conventional banks participating in the SPTF scheme were allowed to upgrade their IBUs into an Islamic Banking Division.[154] Such divisions were allowed to offer all types of Islamic banking services.[155] Also, a second Islamic bank has been established in Malaysia in 1999 namely; the Bank Muamalat Malaysia Berhad.[156]

---

[150] *See generally* http://www.bankislam.com.my
[151] Aishah Bidin, *Islamic Banking in Malaysia: Reconciling Religious Law and the Common Law*, 1(4) J. OF INT'L BANK. REG. 75, at 76, (2000)
[152] THANI ET. AL, *supra* note 133, at 18.
[153] Bidin, *supra* note 151, at 76.
[154] *Id.*
[155] *Id.*
[156] *See generally* http://www.muamalat.com.my

In line with these developments; an Islamic inter-money market was introduced to facilitate the inter-bank trading in Islamic financial instruments.[157] The government also allowed the issuance of non-interest bearing investment certificates to facilitate the operations of the Islamic banks that are unable to trade in Treasury Bills or other interest-based papers such as government bonds.[158] These non-interest bearing interests are known as the Government Investment Certificates (GIC) which were introduced under a certain concept under Islamic law.[159]

Clearly, in the period between 1983 and 1999 Malaysia has been gradually introducing Islamic financial services to its market and in turn creating some form of dualism in its financial system (*i.e.,* the existence of Islamic and conventional finance). To further build an efficient Islamic financial system along its conventional counterpart, Malaysia has established the National *Shari'a* Advisory Council for Islamic Banking and *Takaful* (NSAC) in May 1997. The main aim of the NSAC is to act as the sole authority body to advise the central bank of Malaysia, Islamic banks, conventional banks offering Islamic products and *takaful* companies on Islamic *Shari'a* issues.[160]

However, in developing the "Islamic finance" component in Malaysia, the educational dimension has not been overlooked. Entities have been established to provide a platform of interaction and to develop awareness and research. To this effect, the Association of Islamic Banking Institutions Malaysia[161] and the Islamic Banking and Finance Institute[162] were established.

---

[157] THANI ET. AL, *supra* note 133, at 19.
[158] Bidin, *supra* note 151, at 76.
[159] THANI ET. AL, *supra* note 133, at 19.
[160] COUNTRY FINANCE: MALAYSIA, at 9 (Economic Intelligence Unit, 2004).
[161] *See generally* http://www.aibim.com.my
[162] *See generally* http://www.ibfim.com

2.3.2 THE LEGAL FRAMEWORK RELATING TO "ISLAMIC FINANCE" IN MALAYSIA

The above discussion reveals that the Malaysian government is committed towards the recognition of "Islamic finance" alongside conventional finance. Various Islamic products and players have been introduced and encouraged to build this form of "dualism" in the financial system. The role of law in the implementation of this dual policy in Malaysia is not overlooked. For example, the Malaysian government has passed and reformed certain laws in order to introduce Islamic banking into its financial market and to facilitate its operations. As will be seen, the issue whether the mere enactment of such laws is sufficient is questionable.

The first law which was passed by the Malaysian government to incorporate "Islamic finance" within its financial system, is the Islamic Banking Act (IBA) which came into effect on 11 March 1983.[163] The IBA is modelled on the conventional Malaysian Banking Act of 1973.[164] However, adjustments are contained in the IBA to accommodate the nature of the Islamic banks' operations.[165] The IBA defines the Islamic bank as a "company which carries on Islamic banking business and holds a valid license...".[166] Islamic banking business is defined as "banking business which aims and operations do not involve any element which is not approved by the Religion of Islam".[167]

In order for an Islamic bank to be licensed; the IBA requires that the Islamic bank should establish a *Shari'a* advisory body.[168] Like conventional banks in Malaysia; the IBA brings the licensed Islamic banks under the supervision of the Bank Negara

[163] ISLAMIC BANKING ACT (1983)[hereinafter IBA] *available at* http://www.bnm.gov.my.
[164] This Act has been repealed by the Banking and Financial Institution Act of 1989.
[165] Jane Connors, *Towards a System of Islamic Finance in Malaysia*, *in* ISLAMIC LAW AND FINANCE, 57, at 58 (C. Mallat ed., Graham & Trotman, 1988).
[166] IBA, Part I, Section 2, *supra* note 163.
[167] *Id.*
[168] *Id.* Part II, Section 5(b) (provides that the applicant Islamic bank should provide for the establishment of a *Shari'a* Advisory Body in its articles of association).

Malaysia (*i.e.,* the central bank). The IBA mainly deals with the licensing of Islamic banks,[169] financial requirements and duties of Islamic banks such as reserve funds, the percentage of liquid assets to be held by the Islamic bank and other requirements related to the auditing process.[170] The IBA also deals with the ownership, control and management of Islamic banks,[171] powers of supervision and control over Islamic banks[172] and other issues including penalties and actions against offences by bank directors and employees.[173]

In 1989 the Banking and Financial Institutions Act (BAFIA)[174] was introduced to provide a comprehensive regulatory framework for the Malaysian banking and financial institutions. The BAFIA governs various conventional financial institutions but it does not affect Islamic banks which are governed by the IBA.[175] Under the BAFIA, banking business is defined as " (a) the business of (i) receiving deposits on current account, deposit account, savings account or other similar account, (ii) paying or collecting cheques drawn by or paid in by customers; and (iii) provision of finance...".[176] The BAFIA prevents conventional banks from engaging in wholesale or retail trade including import and export trade except in connection with the realisation of security.[177] Such provision is not included in the IBA meaning that Islamic banks are allowed to engage in trade and commerce as long as it is compatible with Islamic *Shari'a* principles.[178] This shows that the Malaysian

---

[169] *Id.* Part II.
[170] *Id.* Part III.
[171] *Id.* Part IV.
[172] *Id.* Part VI.
[173] *Id.* Part VII.
[174] BANKING AND FINANCIAL INSTITUTIONS ACT (1989) [hereinafter BAFIA] *available at* http://www.bnm.gov.my.
[175] THANI ET. AL, *supra* note 133, at 8.
[176] BAFIA, *supra* note 174, Section 2.
[177] *Id.* Section 32(1).
[178] THANI ET. AL, *supra* note 133 at 81.

legislator has taken into account the special operation nature of the Islamic banks which relies on profit sharing and trade.

The IBA along with the BAFIA serve to govern and supervise the Malaysian banking system both Islamic and conventional. However, the Malaysian government passed other necessary laws in order to deepen the dual nature of its financial system. One of these laws is the Government Investment Act (1982)[179] which allowed the government to issue non-interest bearing investment certificates in order to make it possible for Islamic banks to meet its legal liquidity requirements. The issuance of the Government Investment Certificates is Islamic compliant.

The Malaysian support towards the creation of a legal framework for a dual financial system in not confined to the banking system. Further steps have been taken by the Malaysian government to develop its "Islamic finance" component. In 1993, the Malaysian government passed the Securities Commission Act (the "Securities Act");[180] which brought the securities industry under the main control of the Securities Commission (SC). The Securities Act applies to both Islamic as well as conventional securities. Under Section 32 of the Securities Act; any person who issues, offers for subscription or purchase, or makes an invitation to subscribe or purchase debentures[181] or Islamic securities would require the approval of the SC.

The SC has released special guidelines for the issuing of Islamic securities. The Guidelines on the Offering of Islamic Securities[182] define "Islamic securities" as

---

[179] *See generally* http://www.bnm.gov.my.
[180] SECURITIES COMMISSION ACT (1993) *available at* http://www.sc.com.my
[181] Item 1.05 (a) of the Guidelines on the Offering of Private Debt Securities (Revised Edition 26 July 2004) states: "the term "debenture" has the meaning assigned to it under subsection 2(1) SCA and used synonymously with the term "private debt securities". Subsection 2(1) of the SCA describes "debenture" to include " debenture stock, bonds, notes and any other evidence of indebtedness of a corporation for borrowed moneys, whether or not constituting a charge on the assets of the corporation...".
[182] GUIDELINES ON THE OFFERING OF ISLAMIC SECURITIES (26 July 2004) *available at* http://www.sc.com.my

"any securities issued pursuant to any *Shari'a* principles and concepts approved by the *Shari'a* Advisory Council as set out in Appendix 1".[183] Appendix 1 of the Guidelines lists and defines the primary as well as other supplementary approved *Shari'a* concepts and principles for structuring and trading of the Islamic securities.[184] However, because Islamic securities are a developing area; the Guidelines have allowed for Islamic securities to be structured on the basis of *Shari'a* principles and concepts other than those listed in Appendix 1 of the Guidelines provided that such principles and concepts are approved by the *Shari'a* Advisory Council.[185]

The SC has also published guidelines for the offering of asset-backed securities. The Guidelines on Offering of Asset-Backed Securities (GOABS)[186] apply to both Islamic as well as conventional issuing of securities. The issuance of asset-backed conventional or Islamic securities should meet the criteria of the GOABS as well as the Guidelines either on Private Debt Securities or Offering of Islamic Securities as the case may be.[187] The GOABS defines "asset-backed securities" or ABS as "private debt securities or Islamic securities that are issued pursuant to a securitisation transaction...".[188] The GOABS also requires that the assets underlying the securitisation transaction should be acceptable in accordance with *Shari'a* principles where the issue, offer or invitation of ABS is Islamic in nature.[189]

---

[183] *Id.* Item 1.05(a).
[184] *Id.* Appendix 1.
[185] *Id.* Item 1.06.
[186] THE GUIDELINES ON OFFERING OF ASSET-BAKED SECURITIES (Revised Edition 26 July 2004) *available at* http://www.sc.com.my.
[187] *Id.* Item 2.01.
[188] *Id.* Item 3.01.
[189] *Id.* Item 4.02.

In addition, the Malaysian government has also passed a law to govern Islamic insurance activities alongside conventional insurance. In 1984, the *Takaful* Act[190] was passed to provide for the licensing and regulation of *takaful* activities.[191] The *Takaful* Act was modelled on the Malaysian conventional Insurance Act of 1983.[192] The Act defines *takaful* as "a scheme based on brotherhood, solidarity and mutual assistance which provides for mutual financial aid and assistance to the participants in case of need whereby the participants mutually agree to contribute for that purpose".[193] The Act further defines "*takaful* business" as that "business of *takaful* whose aims and operations do not involve any element which is not approved by the *Shari'a*".[194]

The Act divides the *takaful* business into family solidarity business and general business.[195] Family solidarity means "*takaful* for the benefit of the individual and his family".[196] Family solidarity is similar to life insurance in conventional schemes.[197] However, the word *takaful* should not be used by any operator unless registered under the *Takaful* Act.[198] An applicant may be refused to be registered to carry out *takaful* business if the business desired to be carried out involve any element which is not approved by the *Shari'a*.[199] Also, the Articles of Association of the *takaful* operator should provide for the establishment of *Shari'a* Advisory Council.[200] The Act brings the *takaful* industry under the supervision and control of the central bank

---

[190] TAKAFUL ACT 1984 [hereinafter TA] *available at* http://www.bnm.gov.my.
[191] For further information on *takaful*, *see* Chapter One.
[192] Connors, *supra* note 165, at 63. However, the Insurance Act of 1983 was repealed by the Insurance Act of 1996.
[193] TA, Section 2, *supra* note 190.
[194] *Id.*
[195] *Id.* Section 3(1).
[196] *Id.* Section 2.
[197] THANI ET. AL, *supra* note 133, at 63.
[198] TA, Section 6(1), *supra* note 190
[199] *Id.* Section 8(5)(a).
[200] *Id.* Section 8(5)(b).

of Malaysia.[201] Both the Insurance Act of 1996 and the *Takaful* Act of 1984 govern both Islamic and conventional insurance activities.

The above laws have contributed in creating a form of "dualism" in the Malaysian regulatory framework. In doing so, the Malaysian government has taken into consideration all the components of the financial industry. It passed laws and guidelines in connection with the three main components of the financial system: the banks, the capital market and the insurance. However, other laws have been amended in order to accommodate the establishment of an Islamic financial system alongside its conventional counterpart. Thus, tax laws were amended to accommodate the nature of the Islamic banks transactions which might attract extra tax and put the conventional banks at a better competitive position in comparison with Islamic banks. The Stamp Act 1949, the Income Act 1967 and the Real Property Gains Tax Act 1976 were all amended to accommodate Islamic finance operations.[202]

2.3.3 FINAL OBSERVATIONS

The discussion of the "Islamic finance" related laws that have been passed by the Malaysian government in order to facilitate the activities of "Islamic finance" alongside conventional finance reveals that Malaysia has already done considerable effort in developing its legal framework in order to facilitate the creation of a dual financial system. However, criticisms have been directed towards the sufficiency of such efforts. Supporters of an Islamic-based financial system argue that there is still a need for further reforms in order to accommodate "Islamic finance" in Malaysia more effectively.

[201] *Id.* Section 54(1).
[202] *See generally* THANI ET. AL, *supra* note 133.

The Malaysian "Islamic finance" related laws have been criticised as being insufficient or being a "piecemeal" legislation.[203] Thus, despite these "Islamic finance" related laws; Islamic financial services are still functioning in the context of English common law principles as it is applicable in Malaysia.[204] Also, "Islamic finance" related laws may still be interpreted in the light of the conventional financial legislations. Thus, consider the definition of the "Islamic banking business" mentioned above. The term is defined as that business which does not involve any operation not approved by Islam.[205] Bidin argues that such definition of Islamic baking business it is not sufficient in comparison with the definition of the conventional banking business defined in BAFIA.[206] The definition of conventional banking business is more detailed, clear and it is based on common law principles.[207] Bidin argues that in the absence of a clear statutory definition of the Islamic banking business; the practice is to refer to the common law.[208]

Hence, Bidin argues that the IBA intends to define Islamic banking business in the light of the conventional banking business definition with the exception that the operations of Islamic banks should not involve any element not approved by Islam.[209] Such result is not satisfactory however due to the different relationship created between the customers and the Islamic bank. In addition, the critics of the "Islamic finance" related laws seem to agree that these laws are supervisory and regulatory in nature. Thus, the laws do not describe in detail the *Shari'a* compliant

[203] Shanthy Rachagan, *Islamic Banking in Malaysia*, 20 (2) JIBLR 88, at 93, (2005).
[204] THANI ET. AL, *supra* note 133, at 91.
[205] IBA , Section 2, *supra* note 163.
[206] Bidin, *supra* note 151, at 80.
[207] BAFIA, Section 2(1), *supra* note 174 (referring to the common law principles given by Justice Atkins in the case of *Joachimson(A Firm) v. Swiss Bank* (1921) 3 KB 110).
[208] Bidin, *supra* note 151, at 80.
[209] *Id.*

commercial transactions and do not offer any substantive law to govern Islamic financing transactions.[210]

Therefore, in case of a dispute arising from Islamic financing transactions; such dispute would be resolved from a conventional common law perspective especially that such dispute would be referred to the Malaysian civil courts and not to the *Shari'a* courts.[211] In one of the cases brought before the Court of Appeal it was held, *inter alia*, that despite the fact that the facility is an Islamic banking facility; this does not mean that the law applicable is different from that applicable to conventional banking facility.[212] This is another example which shows that Islamic financing transactions are still functioning within common law based principles in Malaysia.

The critics argue that legal practitioners are facing challenges with the current *status quo*.[213] In drafting Islamic financing transactions; legal practitioners will need to satisfy both Islamic law and other laws such as the Contract Act 1950 and Bills of Exchange Act 1949.[214] This result could be difficult to achieve because a contract could be valid under Islamic law but unenforceable from a common law perspective for want of consideration for instance.[215] Hence, it is believed that there is still a need to strengthen the legal infrastructure in order to facilitate Islamic financing transactions. It is suggested that a special Islamic *Shari'a* court should be established to hear Islamic finance related disputes. It is also suggested that there should be a

[210] *See* Connors, *supra* note 165, at 65 & Bidin, *supra* note 151, at 157.
[211] THANI ET. AL, *supra* note 133, at 90.
[212] *See Bank Kerjasama Rakyat Malaysia Bhd v Emcee Corporation Sdn Bhd* (2003) 1 CLJ 625. *See also* Nicholas Foster, *Encounters between Legal Systems: Recent Cases Concerning Islamic Commercial Law in Secular Courts,* 68 AMICUS CURIAE 2, (2006) (referring to the recent case of *Affin Bank Berhad v. Sulkifli Abdullah* (2006)).
[213] THANI ET. AL, *supra* note 133, at 91.
[214] *Id.*
[215] *Id.*

comprehensive Islamic Commercial Code to support the existing Malaysian Islamic regulatory framework.[216]

However, the IIFISS are in the process of developing such laws.[217] These laws might find inroads to the Malaysian legal system. The Malaysian government has achieved a lot in promoting and incorporating "Islamic finance". It was the first Islamic country that attempted to develop "Islamic finance" alongside conventional finance in structured and regulated manners. While there could be certain "unfinished agendas"; the Malaysian example does serve a good model that Saudi Arabia could be inclined to follow during its proposed financial sector law reform.

2.4 CONCLUDING REMARKS

The Section reveals the tremendous development relating to the "Islamic finance" industry at the international, regional and national levels. As "Islamic finance" has become an important *means* of financing, there is an emerging trend towards standardising, regulating, institutionalising and strengthening the "Islamic finance" industry. It seems, however, that this trend has developed in a manner that does not completely clash with conventional finance. The current approach, therefore, is incorporating "Islamic finance" alongside conventional finance.

As explained earlier in this volume, Saudi Arabia itself is witnessing a high activity of "Islamic finance". Saudi Arabia, however, has not followed this current approach. Therefore, the above-discussed "three-dimension" approach would serve as a good starting point to develop the "Islamic finance" component in Saudi Arabia. However, Saudi Arabia is a special case because it is the only country among all the

[216] *Id.* at 94.
[217] *See* discussion of the international dimension *supra*.

above discussed Islamic countries that maintain Islamic *Shari'a* as a paramount legal system of the country and not as a mere source of law.

While Saudi Arabia might have indicated impliedly its willingness to strengthen the "Islamic finance" component as explained in Chapter Two, there seems to be no current trend towards "Islamising" the whole financial sector. Even if the "Islamic finance" component is further developed alongside conventional finance, there will still be an *interaction* between the conventional finance component and Islamic *Shari'a*. To eliminate such interaction, Saudi Arabia may consider *segregating* its conventional finance component from the overall law of Islamic *Shari'a*. The next Section aims to explain this "segregation" phenomenon in the light of the DIFC model and to put the last piece of the "puzzle" to have the full picture.

3. FURTHER LEGAL ENHANCEMENT: THE "SEGREGATION" PHENOMENON

There has always been an interaction between Islamic *Shari'a* and modern commercial and finance practices. The primary sources of the Islamic *Shari'a* have dealt with many issues in generic terms.[218] This is the main reason for the development of the Islamic *fiqh* which provides, based on well founded Islamic principles, human interpretations for these generic terms. However, certain concepts such as *riba* and *gharar* have always been controversial. This, in turn has generated substantial "legal unrests" in respect to conventional finance transactions in the Islamic countries.

Hence, certain innovations have been created to circumvent, to the extent possible, these "legal unrests" and to ensure the Islamic compatibility of the

[218] That is, the *Quran* and *Sunna*. *See* Chapter One.

structure. For example, various types of arrangements have been used in the past to circumvent the prohibition of *riba*.[219] In addition, in the era of globalisation and economic "dependence", the interaction between Islamic *Shari'a* and global economy is more than ever. Certain Islamic countries, therefore, have attempted to reconcile the demands of Islamic *Shari'a* and modern economy requirements at the *macro* level.

Foster argues, for example, that the French distinction between civil and commercial law has been adopted in the UAE to reconcile the demands of Islamic *Shari'a* and those of international business. He explains this situation as follows:

> "This situation presents Middle Eastern legislators drafting commercial legislation with a difficult task, because some basic principles of the *Shari'a* (such as the prohibition of *riba* and *gharar*) cannot, on anything but a very liberal, an minority, interpretation of the *Shari'a*, be reconciled with many important international business practices (such as charging interest and speculation). However, there international practices are so important to the economy of the region that they can not be ignored. The French distinction between civil and commercial law has been adopted as a compromise solution in an attempt to reconcile the demands of the newly resurgent *Shari'a* and those of international business".[220] Foster continues:

> "...the UAE, in common with nearly all other Arab jurisdictions, has adopted it ..., with the result that it is an essential part of the structure of commercial law in the UAE. The UAE Civil Code incorporates *Shari'a* ideas for non-business transactions between individuals in order to satisfy the need of a *Shari'a* element in the law; the Commercial Code incorporates international commercial practice for business transactions".[221]

[219] Nicholas Foster, *Commercial Security Over Movables in the UAE: A Comparative Analysis in the Light of English Law, French Law and the Shari'a*, 4 YEARBOOK ISLAMIC & MIDDLE EASTERN L. 3, at 21 (1997-1998) (referring to various contractual/property indirect mechanisms, the co-called "*hiyal*" (*i.e.*, stratagems) to avoid riba. These include double sale and sale with right of redemption).
[220] Foster, *supra* note 219, at 6.
[221] *Id.* at 7.

Nevertheless, this approach of reconciliation has not eliminated completely the implications of the Islamic *Shari'a*. Thus, the UAE in establishing the Dubai International Financial Centre (DIFC), has followed completely a different approach as will be explained below. It is fair to say, however, that Foster has presented a correct example of how Islamic countries have been trying to reconcile Islamic *Shari'a* and modern economy requirements. Even the Saudi *existing de facto duality* discussed throughout this volume can be seen as part of this process. Why Saudi Arabia would establish all these committees that the author has discussed in Chapter Two? The aim is to avoid referring cases to the Islamic *Shari'a* courts that might apply conflicting rules with modern financial and commercial transactions.

It is against this background, that the author examines the recent establishment of the DIFC. The DIFC is a free zone that focuses on various areas of financial activity and it is located in the UAE.[222] The DIFC is seen as a part of a larger vision to create an environment for progress and economic development in the UAE.[223] Having been established as a free zone, the DIFC is based on the notion of *segregating* in whole the DIFC's financial activities from the legal system of the UAE. It is believed that this "segregation" phenomenon would provide a further legal enhancement by providing a viable legal framework for the DIFC and at the same time eliminating entirely any conflict that might arise between the UAE and the DIFC laws. Here, the DIFC is another innovation relating to financial services in an Islamic country. Rather than going through the thorny route of "reconciliation" the UAE has preferred "segregation" this time.

[222] *See generally* http://www.difc.ae/
[223] *Id.*

The main reason behind such "segregation" is to ensure the efficiency and certainty of transacting financial transactions within the DFIC. Local and foreign investors would be confident that their investments are governed by a well-developed legal framework that can accommodate modern financial transactions. The "segregation" phenomenon is simply a legislative process whereby the UAE government has amended the constitution to allow for the establishment of the DIFC and introduced various laws that are essential for modern financial transactions. The DIFC's "segregation" phenomenon provides a viable model that could serve the Saudi financial sector law reform process. This Section aims to provide an explanation of how the DIFC works and explains the functions of its main founding institutions.

3.1 THE DUBAI INTERNATIONAL FINANCIAL CENTRE (DIFC)

The first step in establishing the DIFC is the amendment made to the UAE's Constitution.[224] Article 121 of the UAE's Constitution was amended to allow for the establishment of free zones including the DIFC.[225] In addition, the UAE enacted the Financial Free Zone Law (FFZL) that allows for the establishment of the free zones in the UAE. The FFZL defines the Financial Free Zone as a "free zone that is established in any Emirate of the State, in which Financial Activities are carried

[224] Michael Blair et. al., *Legal Issues Arising in the New Dubai International Financial Centre,* 20 J.I.B.L.R 207, at 20, (2005).

[225] Article 121, CONSTITUTIONAL AMENDMENT NO. 1 OF 2003, 10 January 2004 *available at* http://www.difc.ae ("the Union shall have exclusive legislative jurisdiction in the following matter-...the order and the manner of establishing Financial Free Zones and the boundaries within which they are exempted from having to apply rules and regulations of the Union").

out".[226] Then, the Crown Prince of Dubai issued a Decree (the "Decree") that provides for the establishment of the DIFC.[227]

Following the Decree, the Law of the Dubai International Financial Centre (the "DIFC Law") was passed.[228] The DIFC Law establishes a financial free zone area in the Emirate of Dubai.[229] The DIFC is presided by a President who is appointed by a decree[230] and it is supervised by a Board of Directors.[231] The DIFC Law empowers the President with certain powers and duties that include, *inter alia,* approving the policies of the DIFC,[232] submitting the proposed laws for the Ruler's approval,[233] issuing the DIFC's Regulations[234] and creating any administrations or entities to achieve the objectives of the DIFC.[235]

In addition, the DIFC Law establishes within the DIFC the following bodies: 1) the Dubai International Financial Centre Authority (DIFCA); 2) the Dubai International Financial Centre Financial Services Authority (DFSA) and 3) the Dubai International Financial Centre Judicial Authority.[236] The DIFCA is the legal representative of the DIFC and it can sue and be sued in this capacity.[237] It is independent from any other DIFC's bodies[238] and it has its own budget.[239] The DIFCA has various roles that include, *inter alia,* proposing to the President all the

[226] Article 1, FEDERAL LAW NO. (8) OF 2004 CONCERNING FINANCIAL FREE ZONES, 14 March 2004 *available at* http://www.difc.ae.
[227] FEDERAL DECREE NO. (35) FOR THE YEAR 2004TO ESTABLISH FINANCIAL FREE ZONE IN DUBAI, 27 June 2004 *available at* http://www.difc.ae.
[228] DUBAI LAW NO. 9 OF 2004 IN RESPECT OF THE DUBAI INTERNATIONAL FINANCIAL CENTRE, 14 September 2004 *available at* http://www.difc.ae.
[229] *Id.* art. 3(1).
[230] *Id.* art. 3(2)
[231] *Id.* art 6(1).
[232] *Id.* art. 5(1)(a).
[233] *Id.* art.5(1)(c).
[234] *Id.* art.5(1)(d).
[235] *Id.* art.5(1)(g).
[236] *Id.* art. 3(3).
[237] *Id.* art. 3(4).
[238] *Id.* art. 6(2).
[239] *Id.* art. 6(3).

strategies and policies of the DIFC,[240] reviewing and submitting to the President the DIFC's proposed laws,[241] reviewing and issuing any DIFC's proposed regulations[242] and establishing representative office to promote the objectives of the DIFC.[243]

The DIFCA has an Executive which is supervised and managed by the Director General.[244] The Director General, who is a *de facto* member of the DIFCA's Board of Directors,[245] is appointed to implement the various strategies and policies of the DIFC.[246] In addition, the Advisory Board is established to assist the DIFCA in achieving its objectives through providing advices to the DIFCA.[247] Finally, the DIFCA has a Legislature that is responsible for drafting the DIFC's laws and regulations.[248] As will be seen, various laws are introduced to facilitate the activities of the DIFC.

To enhance the confidence in the DIFC, the DIFC Law establishes a special and separate regulator for the sole purpose of supervising the DIFC, namely; the DFSA.[249] The DIFC Law grants the DSFA certain powers and functions that enable it to achieve its main objective which is the regulation of the financial services and other related activities in the DIFC. The powers of the DFSA include, *inter alia,* proposing to the President of the DIFC laws related to the financial regulation,[250] issuing the financial regulation laws,[251] developing relations with other institutions

[240] *Id.* art.6(4)(a).
[241] *Id.* art.6(4)(d).
[242] *Id.* art.6(4)(g).
[243] *Id.* art.6(4)(k).
[244] *Id.* art.6(6).
[245] *Id.*
[246] *Id* .art. 6(6)(a) - (k).
[247] *Id.* art. 6(8).
[248] *Id.* art. 6(7).
[249] *Id.* art. 7(2).
[250] *Id.* art 7(8) (a).
[251] *Id.* art 7(8) (g).

inside and outside Dubai for the purpose of achieving its objective[252] and establishing ancillary bodies that are necessary for the discharging its functions.[253]

In addition, the DIFC Law establishes a special DIFC judicial system to ensure the enforcement of the DIFC law away from any other conflicting laws that might exist under Dubai's law or the Federal law of the U.A.E. To this effect, the DIFC Law establishes the DIFC Courts that should function in an independent manner in accordance with the DIFC Law and other laws under the DIFC.[254] While the courts in Dubai have jurisdiction over any crimes that take place in the DIFC,[255] the DIFC Courts have exclusive jurisdiction to hear and determine any disputes arising out of any transaction carried out in the DIFC.[256] In addition, the DIFC Courts have also the exclusive competence to interpret the DIFC laws.[257]

The above bodies are established to govern the activities of the DIFC. However, the entities that function within the DIFC can be divided into two main types, namely, the Licensed Centre Establishments and the Centre Establishments. The Licensed Centre Establishments are those entities that are licensed, registered or otherwise authorised to carry on financial and banking business including other activities authorised by the law.[258] This includes, *inter alia,* Islamic financings,[259] insurance, re-insurance,[260] the trading and advising on securities,[261] pension funds, investment funds, trust services[262] and legal, auditing and accounting.[263]

---

[252] *Id.* art 7(8) (i).
[253] *Id.* art 7(8) (j).
[254] *Id.* art 8(1).
[255] *Id.* art 8(3).
[256] *Id.* art 8(2)
[257] *Id.* art 8(4).
[258] *Id.* art. 2.
[259] *Id.* art. 9.
[260] *Id.* art. 9(2).
[261] *Id.* art. 9(3).
[262] *Id.* art. 9(5).
[263] *Id.* art. 9(8).

The Centre Establishments include any entity or business duly established or carrying out an activity in the DIFC including any Licensed Centre Establishment.[264] The Centre Establishments should carry their activities in accordance with the DIFC laws. The Centre Establishments can be located outside the DIFC for a period not exceeding four years from the date of the DIFC establishment. Their activities, however, are still subject to the DIFC laws.[265]

In addition, to further enhance the role of the DIFC as an international financial centre, the DIFC Law imposes no tax on the DIFC's bodies and the Centre Establishments or their employees.[266] This extends to a period of 50 years since the establishment of the DIFC and it is renewable to a similar period upon the issuance of a resolution by the Ruler of Dubai.[267] The DIFC Law offers further security to the DIFC through expressly providing that the DIFC's bodies and the Centre Establishments are not subject to any nationalisation procedures or any restrictions in regard to personal ownership.[268] Finally, the DIFC Law provides that any law that contradicts its provision shall be repealed.[269]

3.2 THE DUBAI INTERNATIONAL FINANCIAL EXCHANGE

The Dubai International Financial Exchange (DIFX) is a recent international exchange located in the DIFC and was opened in September 2005.[270] The DIFX, which is incorporated as a limited liability company,[271] aims to provide a platform for access to regional and global capital. The DIFX's products include equities, bonds, funds, Islamic products, Index products and derivatives. The establishment of

[264] *Id.* art.10.
[265] *Id.*
[266] *Id.* art.14.
[267] *Id.*
[268] *Id.* art. 15.
[269] *Id.* art. 20.
[270] *See generally* http://www.difx.ae/
[271] The DIFX is incorporated under the COMPANIES LAW, DIFC LAW NO. 2, (2004) *available at* http://www.difc.ae/.

the DIFX as part of the DIFC involved introducing various laws modelled on the laws and practices found in other leading financial centres such as London and New York.[272]

The DIFX maintains a regulatory environment of the highest international standards. Thus, two sets of rules serve as a regulatory framework over the listing and exchanges process. The DIFX Listing Rules[273] regulate the process which companies must follow if their securities to be traded in the DIFX. In addition, the DIFX Business Rules[274] were promulgated to regulate the behaviour of the members operating in the market and to regulate the obligations that members owe to their clients. The DIFX itself is regulated by the DFSA mentioned previously.

However, "Islamic finance" has not been overlooked by the founders of the DIFC as an emerging current trend in international finance arena. To this effect, the DIFX aims to list new and innovative *Shari'a*-compliant Islamic instruments in collaboration with regional intermediaries.[275] Also, the DIFX ambitiously aims to develop a secondary market for Islamic securities which has always been a challenge for the Islamic securities industry.[276]

3.3 THE REGULATORY AND LEGAL FRAMEWORKS IN THE DIFC

The establishment of the DIFC is based on the "segregation" phenomenon. Thus, the DIFC is a free zone which is completely *segregated* from the overall legal and supervisory systems of the UAE. However, this would have left the DIFC in

---

[272] *See* Michael Blair & Jamie Orchard, *Legal Issues Arising in the New Dubai International Financial Centre*, 20 J.I.B.L.R 207, at 207, (2005).

[273] THE DIFX LISTING RULES, September (2005) *available at* http://www.difx.ae/.

[274] THE DIFX BUSINESS RULES, September (2005) *available at* http://www.difx.ae/.

[275] http://www.difx.ae/listing/products/islamic_products.html.

[276] *See generally* Fuad Al-Omar et. al., *Challenges Facing Islamic Banking in the 21st Century, in* PROCEEDINGS OF THE SECOND HARVARD UNIVERSITY FORUM ON ISLAMIC FINANCE (October 9-10, 1998), 243 (Centre for Middle Eastern Studies-Harvard University,1999). *See also,* Jassar Al Jassar, *Islamic Finance: Success, Prospects, and Neglected Areas, in* PROCEEDINGS OF THE FORTH HARVARD UNIVERSITY FORUM ON ISLAMIC FINANCE (September 30 - October 1 2000), 173 (Centre for Middle Eastern Studies-Harvard University, 2002)

legal and regulatory vacuums if no legal and regulatory alternatives have been introduced. To this effect, the establishment of the DIFC involved the enactment of laws and regulations at both levels, that is, laws forming a viable legal infrastructure combined with a "second level" of financial regulation and supervision. These laws and regulations constitute the legal framework of the DIFC.

To achieve this objective, the DIFC enacted several laws to facilitate transacting financial transactions. These include, *inter alia,* the following:[277] the Limited Partnership Law,[278] Companies Law,[279] Personal Property Law,[280] Employment Law,[281] Law of Obligations,[282] Implied Terms in Contract and Unfair Terms,[283] Law of Damages and Remedies,[284] Law of Security,[285] Limited Liability Partnership Law,[286] Contract Law,[287] Insolvency Law,[288] Arbitration Law,[289] Trust law[290] and Collective Investment Law.[291] All these laws are separate from corresponding laws under the UAE law (if any) and can be enforced by the DIFC courts.

At the regulatory level, a robust regulatory system has been created to govern the DIFC activities. The DFSA, as mentioned earlier, is the sole regulator of the DIFC and overseas DIFC's financial activities. Certain laws are administered by the DFSA which include:[292] the Regulatory Law,[293] Markets Law,[294] Law Regulating Islamic

[277] This list is not exhaustive: for full details and to download all these laws visit http://www.difc.ae unless indicated otherwise.
[278] LIMITED PARTNERSHIP LAW, DIFC LAW NO. 4 OF 2006.
[279] COMPANIES LAW, DIFC LAW NO. 3 OF 2006.
[280] PERSONAL PROPERTY LAW, DIFC LAW NO. 9 OF 2005.
[281] EMPLOYMENT LAW, DIFC LAW NO. 4 OF 2005.
[282] LAW OF OBLIGATIONS, DIFC LAW NO. 5 OF 2005.
[283] THE IMPLIED TERMS IN CONTRACTS AND UNFAIR TERMS LAW, DIFC LAW NO. 6 OF 2005.
[284] LAW OF DAMAGES AND REMEDIES; DIFC LAW NO. 7 OF 2005.
[285] LAW OF SECURITY, DIFC LAW NO. 8 OF 2005.
[286] LIMITED LIABILITY PARTNERSHIP LAW, DIFC LAW NO. 5 OF 2004.
[287] CONTRACT LAW, DIFC LAW NO. 6 OF 2004.
[288] INSOLVENCY LAW, DIFC LAW NO. 7 OF 2004.
[289] ARBITRATION LAW, DIFC LAW NO. 8 OF 2004.
[290] TRUST LAW, DIFC NO. 11 OF 2005 *available at* http://www.difccourts.ae
[291] COLLECTIVE INVESTMENT LAW, DIFC NO. 1 OF 2006 *available at* http://www.difccourts.ae
[292] *See generally* http://www.dfsa.ae/.

Financial Business,[295] Data Protection Law,[296] Trust Law,[297] Collective Investment Law[298] and Investment Trust Law.[299] In addition, other Rules can be made under any law administered by the DFSA. These DFSA Rules are subsidiary legislations and contained in the DFSA Rulebook Modules.[300]

"Islamic finance" is again incorporated under the activities of the DIFC. Thus, conducting Islamic financial business is defined by the law as: "carrying on one or more Financial Services in accordance with *Shari'a*".[301] In addition, any authorised firm which has been endorsed a license to conduct Islamic business is required to appoint a *Shari'a* Supervisory Board.[302] The above discussion reveals that there has been a whole importation of law models that facilitate financial activities and that are segregated from the UAE's legal system.

3.4 FINAL OBSERVATIONS

The establishment of the DIFC as a free zone can be attributed to the fact that the UAE needs to create such a centre in a short period of time. Thus, undertaking financial and legal reforms for the whole legal system in the UAE could be a lengthy process. Alternatively, the UAE has chosen to start from scratch and to build a whole new system that accommodates the DIFC. The DIFC model has introduced a new phenomenon, namely; the "segregation" to the Islamic and other neighbouring G.C.C countries. The main idea behind such phenomenon is to build a robust rule-based

---

293 REGULATORY LAW, DIFC LAW NO.1 OF 2004.
294 MARKETS LAW, DIFC LAW NO. 12 OF 2004.
295 LAW REGULATING ISLAMIC FINANCIAL BUSINESS, DIFC LAW NO.13 OF 2004 (as amended by DIFC LAWS AMENDMENT LAW 2005, DIFC LAW NO.2 OF 2005 ON 19 APRIL 2005)[hereinafter LAW REGULATING ISLAMIC FINANCE] *available at* http://www.dfsa.ae/.
296 DATA PROTECTION LAW, DIFC LAW NO. 9 OF 2004.
297 *See supra* note 290.
298 COLLECTIVE INVESTMENT LAW, DIFC LAW NO. 1 OF 2006. *See also* Michael Blair et. al., *A New Framework for Collective Investment Funds in the Middle East*, 21(8) J.I.B.L.R 440, (2006).
299 INVESTMENT TRUST LAW, DIFC LAW NO. 5 OF 2006.
300 However, another sourcebook is published, namely; the DFSA Sourcebook Modules. This sourcebook contains matters which are not Rules, such as application forms and notices.
301 LAW REGULATING ISLAMIC FINANCE, *supra* note 295, Section 10(1).
302 *Id.* Section 13(1).

financial centre that attracts investments but at the same time eliminating any conflict with the national laws to the largest extent possible. In this case, eliminating the conflict has been achieved through the phenomenon of "segregation". In fact, this would not only achieve elimination but complete protection.

4. SAUDI ARABIA: FURTHER "DUALISING" THE FINANCIAL LEGAL SYSTEM

The previous discussion has presented the efforts that the IIFISS and other Islamic countries have been undertaking to address different issues related to the financial services including the development of the Islamic finance industry. It is the author's belief that a combination of these efforts provide a good model for Saudi Arabia and can be considered in order to create the desired market-led, rule-based, "rule of law" oriented financial system. This "combination approach" attempts to modify the *existing de facto duality* discussed in Chapter Two to bring to existence a *new modified duality*. In doing so, the implications of the *existing de facto duality* are eliminated and hence financial transactions such as securitisations can be properly transacted in a *rule-based* and *"rule of law" oriented* manners.

This "combination approach" is basically a *combination* of the "three-dimension" approach and the "segregation" phenomenon. The "three-dimension" approach aims to develop the "Islamic finance" component in Saudi Arabia in the light of the international, regional and national above-mentioned examples. The "segregation" phenomenon is simply a legislative interference to eliminate any conflict between modern finance and Islamic *Shari'a*. This should particularly deal with the conventional finance component of the Saudi financial system. However, the effect of the "segregation" phenomenon can be further expanded to include *segregating* the "Islamic finance" component from the overall Saudi legal system for a particular period of time. This is to ensure that no conflict arises between the general interpretations of the Islamic *Shari'a* and "Islamic finance" related laws which are normally based on modern interpretations of the Islamic *Shari'a*. Once the "Islamic finance" component establishes stronger roots and robust recognition within the Saudi financial system; then further amendments can be made.

The process of implementing the "combination approach" to create the *new modified duality* is simply a process of further "dualising" the Saudi financial legal system. This is because the Saudi "Islamic finance" component is being further developed to constitute a fully-fledged system to function alongside the conventional finance component. This conventional finance component is also detached from the paramount legal system of Islamic *Shari'a* through implementing the "segregation" phenomenon. Having introduced the "combination approach" as a solution, the question is how this approach would solve the "legal unrests" generated by the *existing de facto duality* discussed in Chapter Two and its associated legal implications on financial transactions such as securitisations. In other words, how would this "combination approach" solve the Saudi dilemma at both the *macro* and *micro* levels.

4.1 DEVELOPING THE "ISLAMIC FINANCE" COMPONENT

Financial activities can not function in a legal or regulatory vacuum. This is also true in the case of "Islamic finance". As discussed throughout this volume, "Islamic finance" exists in Saudi Arabia but it functions within no definitive regulatory or legal frameworks. In order to create the desired market-led, rule-based and "rule of law" oriented financial system; the "Islamic finance" component need to be further developed. This means that Saudi Arabia should consider amending the current financial-related laws or enact new laws that incorporate "Islamic finance" related rules. In either case, the first limb of the "combination approach" (*i.e.,* the "three-dimension" approach) should be given serious consideration by Saudi Arabia.

In doing so, Saudi Arabia should examine three main regulatory laws that have been discussed in Chapter Two. These are: the Banking Control Law (BCL), the Capital Market Law (CML) and the Law on Supervision of Cooperative Insurance Companies (LSCIC). The BCL should clearly address "Islamic finance" and define its activities. The BCL should define "Islamic finance" related methods of financing, such as *murabaha, istisna and ijara.* It should also deal with the composition of the Islamic banks and provide the basis of the legal treatment for their activities. Here, examining the efforts that have been undertaken at the international, regional and national levels offer Saudi legislators good examples.

Similarly, the CML needs to address "Islamic finance" related activities. This means providing clear rules that regulate *sukuk* issuance and define the different types of *sukuk.* For example, the UAE has passed a Resolution to govern the issuance of Islamic bonds. Also, the LSCIC should be clear as to what is considered to be an Islamic compliant insurance. A broad reference to Islamic *Shari'a* is no longer acceptable in the light of the development of "Islamic finance" and its activities. Certain Islamic-compliant structures have developed in relation to insurance services which need to be defined and properly addressed. It should be remembered that it is all about a *rule-based* and a *"rule of law" oriented* market-led financial system. This means certainty and predictability.

Saudi Arabia is also advised to address "Islamic finance" substantive law and not only the supervisory laws. As mentioned earlier, the Ten-Year Master Plan have addressed this issue and IIFISS currently collating efforts and lobbying to convince Islamic countries' governments of the importance of "Islamic finance" related laws and their implementation at the national level. It has been brought to the author's attention that the IFSB has commissioned five international law firms to undertake surveys in relation "Islamic finance" related laws. These include: comparative study on insolvency laws in Islamic finance, comparative study on securities laws in Islamic finance, comparative study on trust laws in Islamic finance and a survey on *Shari'a* Boards across jurisdictions.[303]

It is understandable that these substantive laws are still emerging. However, certain structures are nearly standardised at least at the national level. Structures such as "*sukuk al-ijara*" and other retail banking structures such as Islamic mortgages have been transacted for a considerable period of time. Saudi Arabia, in consultation with the IIFISS, Member States of the G.C.C and other countries such as Malaysia can take the initiatives and attempt to legislate "Islamic finance" related laws that would facilitate Islamic finance transactions. In doing so, Saudi Arabia simply further develops its "Islamic finance" component. This means that "Islamic finance" transactions will function within clear legal and supervisory frameworks.

4.2 IMPLEMENTING THE "SEGREGATION" PHENOMENON

The Saudi financial system comprises two components. The first component is the conventional finance component. The interaction between this "conventional finance" component and the paramount legal system of Islamic *Shari'a* is creating the *existing de facto duality* discussed in Chapter Two and which is also leading to the emerging second component, that is; the "Islamic finance" component. This

303 *See '3rd Seminar on Legal Issues in the Islamic Financial Services Industry Surveys on Legal and Shari'a Issues'*

"Islamic finance" component lacks the legal and regulatory frameworks. The author suggested in the previous Section that such component should be further developed following a "three-dimension" approach.

However, developing the "Islamic finance" component will not entirely solve the "legal unrests" generated by the *existing de facto duality* that have resulted from the interaction between the conventional finance component and the paramount legal system of Islamic *Shari'a.* While the "Islamic finance" component offers a *means* of financing that to some extent could be a functional equivalent to that offered by the conventional finance component; the conventional finance component still exists in Saudi Arabia and the government has not shown any indications as to abolishing such a system. In fact, both the BCL and CML are mainly dealing with the conventional finance component.

Here, the "segregation" phenomenon that has been introduced in the DIFC could serve as a good example for the Saudi legislator. As already mentioned in Chapter Two, the author perceives the *existing de facto duality* as a form of "segregation". Consider again the Committee for the Resolution of Securities Disputes and the Committee for Settlement of Banking Disputes that have been discussed in Chapter Two. It is simply *segregating* the disputes that are related to the financial services from the Islamic *Shari'a* courts. However, it is not similar to that "segregation" phenomenon that has been introduced in the DIFC model.

The DIFC has involved a whole importation of laws, regulations and entities. It is not necessary to use the same approach in the case of Saudi Arabia. However, the idea of "segregation" can be used in terms of substantive law and the Saudi judicial system. Thus, introducing laws that would facilitate the functions of the conventional finance component of the Saudi financial system. These laws are segregated from the paramount legal system of Islamic *Shari'a* but do function *alongside* the "Islamic finance" component. To this effect, any ambiguities in relation to dispute settlements as explained in Chapter Two should be ratified. For example, any ambiguities in the establishing Resolutions of the Committee for Settlement of Banking Disputes, as discussed in Chapter Two, should be abolished.

The author acknowledges the difficulties that are associated with such approach. These difficulties are mainly political and the belief that such "segregation" might simply eliminate the role of the Islamic *Shari'a*.[304] However, Islamic *Shari'a* is playing a major role through the development of the "Islamic finance" component of the Saudi financial system. Investing in the development of the "Islamic finance" component might absorb the difficulties that might arise when implementing the "segregation" phenomenon to the conventional finance component.[305] In addition, because the author perceived the *exiting de facto duality* as a form of segregation in Chapter Two, it is in the author's opinion that there are no

[304] The political difficulties mainly relate to the existing Saudi political composition and the influence of the "*ulama*". The term *ulama* is used to include all recognised religious scholars, the judges of the different ranks, religious lawyers and all other scholars engaged in the Saudi judicial system. Those *ulama* are represented by different institutions such as the Assembly of Senior *Ulama*, the Higher Council of Qadis (Judges), the Supervision of Religious Affairs and the Committee for the Commendation of Virtue and the Prevention of Evil (sometimes referred to as the moral police). These institutions could have influence on the Saudi political decisions and in turn certain legal policies. Hence, there could be a tension between the Saudi government's policy of modernisation in certain aspects on the one hand and these religious institutions on the other. The Saudi government's approach has always been to contain these institutions given the fact that the Saudi political and legal systems are based on Islamic principles. For a good discussion of such tension and its implications on the Saudi legal system *see* Frank Vogel, ISLAMIC LAW AND LEGAL SYSTEM: STUDIES OF SAUDI ARABIA, (Koninklijke Brill NV, 2000).

[305] In addition, thinking positively, with the recent "Islamic finance" developments that are happening at the international level; Islamic countries could be linked with the international capital markets through "Islamic finance". The London Stock Exchange is already witnessing *sukuk* listing. In other words "Islamic finance" is no longer a national or regional phenomenon. So, developing the "Islamic finance" component alongside the conventional finance component offers a strategy for Saudi Arabia that can lead to further developing an "Islamic finance" based system when it gains further recognition.

obstacles to complete this "unfinished agenda" and to implement the "segregation" properly.

4.3 THE "COMBINATION APPROACH" AND FINANCIAL TRANSACTIONS

Having explained the author's vision in relation to the Saudi financial sector law reform through the implementation of the "combination approach"; it is helpful to consider what this would mean to financial transactions such as securitisation and secured transactions that have been discussed in this volume.

4.3.1 SECURITISATIONS

The volume has addressed asset-backed securitisations as a case study to highlight to the reader the adverse implications of the *existing de facto duality* on financial transactions. It has also discussed "Islamic securitisations" as an emerging product in Saudi Arabia and which lacks a definitive legal framework. In proposing the "combination approach", it is the author's belief that both conventional and Islamic securitisations could be transacted in line with the requirements of a market-based economy; that is, rule-based and "rule of law" oriented.

Thus, implementing the "segregation" phenomenon would mean that transacting conventional securitisation transactions are segregated from the overall legal system of Islamic *Shari'a.* Most importantly is the "sale of assets" in securitisation transactions and the risk that there is no definitive legal mechanism that effects the transfer of these assets as discussed in Chapter Three. "Segregation" would mean here passing a securitisation law that settles this issue and hence there is more certainty in this regards. The form of "segregation" that Saudi Arabia wishes to apply may vary depending on what Saudi Arabia aims to achieve. Since securitisation is not the only financial transaction that Saudi Arabia wishes to facilitate, implementing the “segregation” phenomenon could involve passing several laws to ensure that financial transactions within the conventional component are transacted effectively.

Turning to “Islamic securitisations”; here developing the Saudi “Islamic finance” component will contribute towards facilitating “Islamic securitisations” and the issuance of sukuk. The legal framework will be more certain and hence it will be easier to obtain legal opinions relating to the issuance of sukuk. Therefore, better rating and marketability could be achieved. Again, legislating any laws or regulations related to “Islamic securitisations” or any of the “sukuk structures” should be conducted in consultations with the G.C.C Member States and the efforts by the IIFISS.

4.3.2 Secured Transactions

Addressing the laws related to secured transactions in Saudi Arabia is essential. The author explained various legal tensions that may arise as a result of the interaction between the conventional finance component and the Saudi secured transactions law. As discussed, these legal tensions can be divided into procedural and substantive. Also, it has been argued that the development of the "Islamic finance" component in Saudi Arabia is partly due to the difficulty in obtaining security collateral by conventional banks. The question is, however, what would the "combination approach" mean to the Saudi financial sector law reform as it relates to the area of secured transactions?

Firstly, the interaction between the conventional finance component and secured transactions can be eliminated through the implementation of the "segregation" phenomenon. Secured transactions laws can be further modified to accommodate conventional finance practices. Security interests under such laws can have a "special" enforcement mechanism that would allow for their enforcement effectively.

Secondly, the Saudi "Islamic finance" component should be further developed because "Islamic finance" has provided an alternative mechanism of financing to circumvent any "legal unrests" resulting from the interaction between the conventional finance component and the paramount legal system of Islamic *Shari'a*. Again, Saudi Arabia can be guided by the 'three-dimension' approach discussed earlier. In the area of collective security arrangements, Saudi Arabia may consider the possibility of introducing trust laws. Bahrain has already done it and the IFSB is currently studying the possibility of introducing the concept of trust in the Islamic countries.

5. CONCLUSION

This volume has established that Saudi Arabia aims to establish a market-led financial system. In the light of the discussions in Chapter One, such market-led financial system should be a rule-based and a "rule of law" oriented with acceptable levels of predictability and certainty. In addition, the discussions in Chapter Two reveal that there is an *existing de facto duality* that affects the qualities of these market economy requirements and has adverse implications on the Saudi legal system at the *macro* level. Also, in subsequent Chapters; the implications of this *existing de facto duality* have been examined at the *micro* level in respect to financial transactions such as securitisations and secured transactions. Furthermore, throughout the volume; the author highlighted that there is an emerging "Islamic finance" trend and an appetite towards "Islamic finance" products such as "Islamic securitisation". This emerging "Islamic finance" component, however, lacks a definitive legal framework in Saudi Arabia unlike other Islamic countries.

Hence, the dilemma of the Saudi financial system has been identified as being the *exiting de facto duality*, that is; the interaction between the conventional finance component and the paramount legal system of Islamic *Shari'a* as well as the emerging of an "Islamic finance" component that lacks regulatory and legal frameworks. At this juncture, it is the author's belief that further "dualising" the Saudi financial legal system would create a financial system that meets the requirements of a market-economy. This can be achieved through the implementation of the "combination approach" on which this Chapter has provided the "road map". In sum, the development of the "Islamic finance" component in the light of the "three-dimension" approach. Simultaneously, segregating the conventional finance component form the paramount legal system of Islamic *Shari'a*.

BIBLIOGRAPHY

OFFICIAL DOCUMENTS

Saudi Arabia

- Arbitration Regulations, Royal Decree No. M/46, (1983).
- Circular No. 10207, Ministry of Interior (1988). (Accelerating the enforcement of the Committee for Settlement of Banking Disputes) (Arabic).
- Circular No. 12/138, Ministry of Justice, "Judicial Circular to All Courts", (1987) (a circular circulated by the Minister of Justice instructing the Islamic courts to refer banking disputes to Committee for Settlement of Banking Disputes).
- Commercial Court Regulations, Royal Decree No. 32, June (1931).
- Commercial *Rahn* Law, Royal Decree No. M/75, (2003).
- Company Regulations, Royal Decree No. M/6, July (1966).
- Constitution of Saudi Arabia, March (1992).
- Negotiable Instruments Regulation, Royal Decree No. M/37, February (1964).
- Offering Circular, Saudi Basic Industries Corporation, 3 July 2006.
- Real Estate Development Fund Law, Royal Decree No. M/23, (1974).
- Resolution No. 729/8, Establishing the Committee for Settlement of Banking Disputes, March (1987). (Arabic)
- Rules of the Internal Procedures of Committee for Settlement of Banking Disputes, No. 3/86620, (1988) (Arabic).
- Saudi Arabian Monetary Agency, Forty-Second Annual Report (2006).
- Saudi Credit Bank Law, Royal Decree No. M/44, (1973).
- Saudi Industrial Development Fund Law, Royal Decree No. M/3, (1974).
- Saudi Law on Supervision of Co-operative Insurance Companies (Royal Decree M/5) (2003).
- The Authorised Persons Regulations, Royal Decree M/30, June (2005).
- The Banking Control Law, Royal Decree No. M/5, June (1966).

- The Capital Market Law, Royal Decree M/3, (2003).
- The Charter of the Saudi Arabian Monetary Agency, Royal Decree 23, December (1952).
- The Eighth Development Plan (2005 – 2009).
- The Fifth Development Plan (1990 – 1995)
- The First Development Plan (1970 – 1975).
- The Fourth Development Plan (1985 – 1990).
- The Law of Judiciary, Royal Decree No. M/64, July (1975).
- The Listing Rules, Royal Decree M/30, October (2004).
- The Market Conduct Regulations, Royal Decree M/30, October (2004).
- The Regulations of Offers of Securities, Royal Decree M/30, (2004)
- The Second Development Plan (1975 – 1980).
- The Seventh Development Plan (2000 – 2005).
- The Sixth Development Plan (1995 – 2000).
- The Third Development Plan (1980 -1985).

Miscellaneous

- AAOIFI, Accounting, Auditing & Governance Standards for Islamic Financial Institutions (2005).
- Dubai International Financial Centre, Arbitration Law, DIFC Law No. 8 of 2004.
- Dubai International Financial Centre, Collective Investment Law, DIFC No. 1 of 2006
- Dubai International Financial Centre, Companies Law, DIFC Law No. 3 of 2006.
- Dubai International Financial Centre, Contract Law, DIFC Law No. 6 of 2004.
- Dubai International Financial Centre, Employment Law, DIFC Law No. 4 of 2005.
- Dubai International Financial Centre, Insolvency Law, DIFC Law No. 7 of 2004.
- Dubai International Financial Centre, Law of Damages and Remedies; DIFC Law No. 7 of 2005.

- Dubai International Financial Centre, Law of Obligations, DIFC Law No. 5 of 2005.
- Dubai International Financial Centre, Law of Security, DIFC Law No. 8 of 2005.
- Dubai International Financial Centre, Law Regulating Islamic Financial Business, DIFC Law No.13 of 2004 (as amended by DIFC Laws Amendment Law 2005, DIFC Law No.2 of 2005 on 19 April 2005
- Dubai International Financial Centre, Limited Liability Partnership Law, DIFC Law No. 5 of 2004.
- Dubai International Financial Centre, Limited Partnership Law, DIFC Law No. 4 of 2006.
- Dubai International Financial Centre, Markets Law, DIFC Law No. 12 of 2004.
- Dubai International Financial Centre, Personal Property Law, DIFC Law No. 9 of 2005.
- Dubai International Financial Centre, Regulatory Law, DIFC Law No.1 of 2004.
- Dubai International Financial Centre, The Implied Terms in Contracts and Unfair Terms Law, DIFC Law No. 6 of 2005.
- Dubai International Financial Centre, Trust law, DIFC No. 11 of 2005
- Dubai International Financial Exchange, The DIFX Business Rules, September (2005).
- Dubai International Financial Exchange, The DIFX Listing Rules, September (2005)
- Dubai Law No. 9 of 2004 in Respect of the Dubai International Financial Centre, 14 September 2004.
- European Bank for Reconstruction and Development, Agreement Establishing the European Bank for Reconstruction and Development, 29 March 1991.
- Federal Decree No. (35) for the year 2004 To Establish Financial Free Zone in Dubai, 27 June 2004.
- Federal Law No. (8) of 2004 Concerning Financial Free Zones, 14 March 2004.

- International Islamic Rating Agency, Methodology for *Shari'a* Quality Rating, May 2006.
- Islamic Development Bank and Islamic *Fiqh* Academy, Resolutions and Recommendations of the Council of the Islamic Fiqh Academy (1985-2000), (2000).
- Islamic Financial Services Board, Capital Adequacy Standard for Institutions (other than Insurance Institutions) Offering Only Islamic Financial Services, December (2005).
- Islamic Financial Services Board, Exposure Draft No. 4 Disclosures to Promote Transparency and Market Discipline for Institutions Offering Islamic Financial Services (Excluding Insurance (Takaful) Institutions and Islamic Mutual Funds), December (2006).
- Islamic Financial Services Board, Exposure Draft No. 5 Guidance on Key Elements In the Supervisory Review Process of Institutions Offering Islamic Financial Services (Excluding Insurance (Takaful) Institutions and Islamic Mutual Funds), December (2006).
- Islamic Financial Services Board, Guiding Principles of Risk Management for Institutions (other than Insurance Institutions) Offering Only Islamic Financial Services, December (2005).
- Islamic Financial Services Board, Guiding Principles On Corporate Governance For Institutions Offering Only Islamic Financial Services (Excluding Islamic Insurance (*Takaful*) Institutions And Islamic Mutual Funds), December (2006).
- Islamic Financial Services Board, Issues in Regulation and Supervision of *Takaful* (Islamic Insurance), August (2006).
- Islamic Research and Training Institute – IDB and Islamic Financial Services Board, The Islamic Financial Services Industry Ten-Year Master Plan (2006-2015): A Framework (Draft for Discussion Only), (2006).

- Kingdom of Bahrain, Law No. (23) of the Year 2006 Regarding the Regulation of Financial Trusts (2006).
- Organisation of the Islamic Conference, Charter of the Islamic Organisation of the Islamic Conference, (1 February 1974).
- Reference Model Regulation (Law) for the Promotion of Foreign Investment in the Gulf Co-operation Council States.
- The Gulf Co-operation Council Charter.
- The Gulf Co-operation Council, Economic Agreement, December, 31, (2001).
- The Gulf Co-operation Council, Long Term Comprehensive Development Strategy (2000-2025), (2003).
- The Gulf Co-operation Council, Unified Industrial Development Strategy (revised version), (2000).
- The United Economic Agreement between the Countries of the Gulf Co-operation Council.
- UAE Securities and Commodities Authority, Resolution Concerning the Listing of Islamic Bonds (2005).
- United Nations Commission on International Trade Law (UNCITRAL) Legislative Guide on Privately Financed Infrastructure Projects, United Nations- New York, (2001).
- United Nations Commission on International Trade Law, UNCITRAL Legislative Guide on Insolvency Law (2004).

BOOKS

- Abdallah, Fath, The Legal Regime Of Foreign Private Investment In Sudan and Saudi Arabia, (Cambridge University Press, 2003).
- Abdeen, Adnan, The Saudi Financial System in the Context of Western and Islamic Finance
- Abir, Mordechai, Saudi Arabia: Government, Society and Gulf Crisis, (Routledge, 1993).
- Al-Dukheil, Abdul Aziz, The Banking System and its Performance in Saudi Arabia, (Saqi Books 1995).
- Ali, Nazim, Islamic finance: Current Legal and Regulatory issues, (Harvard Law School, 2005).
- Ali, Paul, The Law of Secured Finance: an International Survey of Security Interests over Personal Property, (Oxford University Press, 2002).
- Amin, Sayed H., Middle East Legal Systems, (Royston Limited-1985).
- Arrowsmith, Sue et. al, Public Procurement: Global Revolution, (Kluwer Law International, 1998).
- Ballantyne, William, Essays and Addresses on Arab Laws, (Curzon Press, 2000).
- Banakar, Reza et al. An Introduction to Law and Social Theory, (Hart Publishing, 2002)
- Baums, Theodor et. al., Asset-backed Securitisation in Europe, (Kluwer Law International, 1996).
- Being, Willard, King Fisal and the Modernisation of Saudi Arabia, (Croom Helm, 1980).
- Bonsall, David, Securitisation, (Butterworths, 1990).
- Bradley, Anthony et. al., Constitutional and Administrative Law, (Addison Wesley Longman, 1997).

- Brown, Nathan, The Rule of Law in the Arab World: Courts in Egypt and the Gulf, (Cambridge University Press, 1997).
- Caprio, Gerard, Building Sound Finance in Emerging Market Economics, (International Monetary Fund, 1994).
- Centre for Middle Eastern Studies, Proceedings of the Forth Harvard University Forum on Islamic Finance (September 30 - October 1 2000), (Harvard University, 2002)
- Centre for Middle Eastern Studies, Proceedings of the Second Harvard University Forum on Islamic Finance (October 9-10, 1998), (Harvard University, 1999).
- Centre for Middle Eastern Studies, Proceedings of the Third Harvard University Forum on Islamic Finance (October 1, 1999), (Harvard University, 2000).
- Champion, Daryl, The Paradoxical Kingdom, Saudi Arabia and the Momentum of Reform, (C. Hurst & Co, 2003).
- Chapra, Muhammad, Towards a Just Monetary System, (The Islamic Foundation, 1985).
- Colin Paul et. al, Banking and Capital Markets Companion, (Cavendish Publishing Limited, 2003).
- Comair-Obied, Nayla, The Law of Business Contracts in the Arab Middle East: A Theoretical and Practical Comparative analysis With Particular reference to Modern Legislation, (Kluwer Law International, 1996).
- Cranston, Ross, Principles of Banking Law, (Oxford University Press, 2002).
- Dalhuisen, Jan, on International Commercial, Financial and Trade Law, (Hart Publishing, 2004)
- Dupret, Baudouin et. al, Legal Pluralism in the Arab World, (Kluwer Law International, 1999).

- Effendi, Ismail, et. al, The *Mejelle* being an English Translation of *Majallahel-Ahkam-I-Adliya* and a Complete Code on Islamic Civil Law (Law Publishing Company, 1901; reprint 1967).
- El-Dean, Bahaa, Privatisation and the Creation of a Market-Based Legal System: The Case of Egypt, (Koninklijke Brill NV, 2002).
- El-Naggar, Said, Privatization and Structural Adjustment in the Arab Countries, (International Monetary Fund- 1989).
- Fabozzi, Frank, Accessing Capital Markets Through Securitisation, (Frank J Fabozzi Associates, 2001).
- Faundez, Julio, Good Government And Law: Legal And Institutional Reform In Developing Countries, (Macmillan Press Ltd, 1997).
- Giovanoli, Mario, International Monetary Law: Issues For The New Millennium, (Oxford University Press, 2000).
- Goo, Say et al, International Financial Sector Reform: Standard Setting And Infrastructure Development (Kluwer Law International, 2002)
- Guiguo, Wang et. al, Legal Developments in China: Market Economy and Law (Sweet & Maxwell, 1996).
- Hayek, Friedrich, The Constitution of Liberty, (Routledge and Kegan Paul Ltd, 1960).
- Hayek, Friedrich, The Road to Serfdom, (Routledge, 1944).
- Hooker, Barry, Legal Pluralism: An Introduction to Colonial and Neo-Colonial Laws, (Clarendon Press, 1975).
- Hooper, Charles, The Civil Law of Palestine and Trans-Jordan (Volume 1), (Azriel Printing Works, 1933).
- Hughes, Martin, Selected Legal Issues for Finance Lawyers, (LexisNexis UK, 2003).
- Huxley, Andrew, Religion, Law and Tradition: Comparative Studies in Religious Law, (RoutledgeCurzon, 2002).

- Ibrahim, Ahmed , The Administration of Islamic Law in Malaysia, (Institute of Islamic Understanding Malaysia, 2000).
- Institute of Islamic Banking and Insurance, Encyclopaedia of Islamic Banking and Insurance, (Institute of Islamic Banking and Insurance, 1995).
- Institute of Islamic Banking and Insurance, European Perceptions of Islamic Banking, (Institute of Islamic Banking and Insurance, 1996).
- International Bank for Reconstruction and Development: The State in A Changing World: World Development Report 1997, (Oxford University Press, 1997).
- International Bank for Reconstruction and Development: World Development Report 1996: From Plan To Market, (Oxford University Press, 1996).
- Isachsen, Arne et al., Understanding the Market Economy, (Oxford University Press, 1992).
- Jaffer, Sohail, Islamic Asset Management: Forming the Future for *Shari'a*-Compliant Investment Strategies, (Euromoney Books, 2004).
- Jaffer, Sohail, Islamic Retail Banking and Finance: Global Challenges and Opportunities, (Euromoney Books, 2005).
- Jayasuriya, Kanishka, Law, Capitalism and Power in Asia, (Routledge, New York, 1999).
- Kamali, Mohammad, Islamic Commercial Law: An Analysis of Futures and Options, (Islamic Texts Society, 2000).
- Kay, Ernest, Legal Aspects of Business in Saudi Arabia, (Graham&Trotman Ltd, 1979).
- Klarmann, Reinhard, Islamic Project Finance: A Legal Study With Particular Reference To The Laws Of Switzerland And The United Arab Emirates (Schulthess, 2003)
- Lastra, Rosa et al. Bank Failures and Bank Insolvency Law in Economies in Transition, (Kluwer Law International, 1999).

- Lastra, Rosa, The Reform of the International Financial Architecture, (Kluwer Law International, 2001)
- Lawrence Friedman, A History of American Law, (Simon & Schuster, 1985)
- Lerrick, Alison et. al, Saudi Business and Labor Law: Its Interpretation and Application, (Graham&Trotman Ltd,1987).
- Levinson, M. Guide To Financial Markets, (Profile Books Ltd, 1999).
- Lewis, Hilary et al., Commercial Law In The Middle East, (Kluwer Law International, 1995).
- Lewis, Mervyn et. al, Islamic Banking, (Edward Elgar Publishing Ltd, 2001).
- Likosky, Michael et al., Transnational Legal Processes, (Butterworths, 2002)
- Looney, Robert, Economic Development in Saudi Arabia: Consequences of the Oil Price Decline, (JAI Press INC, 1990).
- Looney, Robert, Saudi Arabia's Development Potential: Application of an Islamic Growth Model, (LexingtonBooks, 1982).
- Lynch, Katherine, The Forces Of Economic Globalisation: Challenges To The Regime Of International Commercial Arbitration (Kluwer Law International, 2003).
- Mallat, Chibli, Islamic Law and Finance, (Graham&Trotman Ltd,1988).
- Marer, Paul et. al., The Transition To A Market Economy: Volumes (1) & (2), (OCDE, 1991).
- Mason, Edward, Economic Planning in Underdeveloped Areas: Government and Business, (Fordham University Press, New York, 1958).
- McCarthy, Justin, The Ottoman Peoples And The End Of Empire, (Arnold Publishers, 2001).
- McCormack, Gerard, Secured Credit under English and American Law, (Cambridge University Press, 2004).
- Meenai, Saeed, The Islamic Development Bank: A Case Study of Islamic Co-operation, (Kegan Paul International, 1989).

- Metz, Helen, Saudi Arabia: a Country Study, (Federal Research Division: Library of Congress, 1993).
- Molyneux, Philip et al., Banking and Financial Systems in the Arab World, (Palgrave Macmillan, 2005).
- Nathif, Adam et al., Islamic Bonds: Your Guide to Issuing, Structuring and Investing in *Sukuk*, (Euromoney, 2004)
- Niblock, Tim, State, Society and Economy in Saudi Arabia, (Croom Helm, 1982).
- Norton, Joseph et al., International Asset Securitisation, (Lloyd's of London Press Ltd, 1995)
- Norton, Joseph et. al, International Monetary and Financial Law upon Entering the New Millennium: Sir Joseph Gold Memorial Series Vol. 1, (BIICL, 2002).
- Norton, Joseph et. al, Yearbook of International Financial and Economic Law (2000-2001), (BIICL, 2003).
- Norton, Joseph et. al., Emerging Financial Markets and Secured Transactions, (Klwuer Law International, 1998)
- Norton, Joseph, Financial Sector Law Reform in Emerging Economics, (The British Institute of International and Comparative Law and The London Institute of International Banking, Finance and Development Law Limited, 2000).
- Oditah, Fidelis, Legal Aspects of Receivables Financing, (Sweet & Maxwell, 1991).
- Ofosu-Amaah, Paatii, Reforming Business-Related Laws to Promote Private Sector Development: The World Bank Experience in Africa, (The International Bank for Reconstruction and Development, 2000).
- Petersen, Hanne et. al, Legal Polycentricity: Consequences of Legal Pluralism in Law, (Dartmouth Publishing Company Limited, 1995).
- Philip, Dew, Saudi Arabia: Restructuring for Growth (Euromoney Books, 2003).
- Pistor, Katharina et. al, The Role of Law and Legal Institutions in Asian Economic Development 1960-1995, (Oxford University Press, 1999).

- Preseley, John et. al, Banking in the Arab Gulf, (Macmillan Academic and Professional Ltd, 1991).
- Pritchard, Robert, Economic Development, Foreign Investment and the Law: Issues of Private Sector Involvement, Foreign Investment and the Rule of Law in a New Era (Kluwer Law International and International Bar Association, 1996).
- Qal Aji, Muhammad, et al., Dictionary Of Islamic Legal Terminology (Arabic-English- French), (Dar An-Nafase, 1996).
- Rahman, Doi Abdur, *Shariah:* The Islamic Law, (Ta Ha Publishers, 1984).
- Rayner, Sue, The Theory Of Contracts In Islamic Law, (Graham & Tortman, 1991).
- Rosenthal, James et. al, Securitisation of Credit, (John Wiley& Sons, 1988).
- Ruttley, Hilary et. al., Commercial Law in the Middle East, (Kluwer Law International, 1995).
- Saleh, Nabil, The General Principles of Saudi Arabian and Omani Company Laws (Statutes and *Shari'a*) (Namara Publications, 1981).
- Saleh, Nabil, Unlawful Gain and Legitimate Profit in Islamic Law: *Riba*, *Gharar* and Islamic Banking, (Graham & Trotman Ltd, 1992).
- Scott, Hal , International Finance: Law and Regulation, (Sweet & Maxwell, 2004).
- Seidman, Ann et. al., State And Law In The Development Process: Problem Solving and Institutional Change in the Third World, (Macmillan, 1994).
- Seidman, Ann, et. al., Making Development Work: Legislative Reform For Institutional Transformation And Good Governance, (Kluwer Law International, 1999).
- Sick, Gary, et al. The Persian Gulf at the Millennium: Essays in Politics, Economy, Security, and Religion, (Macmillan Press Ltd, 1997).
- Tennekoon, Ravi, The Law and Regulation of International Finance, (Butterworths, 1991).

- Thani, Nic et Al., Law And Practice Of Islamic Banking And Finance (Sweet & Maxwell, 2003).
- Thiele, Anna, Collective Security Arrangements: A Comparative Study of Dutch, English and German Law, (Kluwer Legal Publishing, 2003).
- Thomas, Abdul Kader et. al., Structuring Islamic Finance Transactions, (Euromoney Books, 2005).
- Usmani, Muhammad, An Introduction To Islamic Finance (Kluwer Law International, 2002)
- Vogel, Frank et al., Islamic Law and Finance: Religion, Risk, and Return, (Kluwer Law International, 1998).
- Vogel, Frank, Islamic Law and Legal System: Studies of Saudi Arabia, (Koninklijke Brill NV, 2000).
- Wamsley, John, Joint Ventures in the Kingdom of Saudi Arabia,(Graham & Trotman, 1985).
- Watson. Alan, Legal Transplants: An Approach to Comparative Law, (1974).
- Wilson, Rodney, Economic Development in Saudi Arabia, (RoutledgeCurzon, 2004).
- Wilson, Rodney, Islamic Finance, (FT Financial Publishing, 1997).
- Wilson, Rodney, Islamic Financial Markets, (Routledge, 1990).
- Wood, Philip, Comparative Law of Security and Guarantees, (Sweet and Maxwell. 1995).
- Wood, Philip, International Loans, Bonds and Securities Regulation, (Sweet &Maxwell, 1995).
- Wood, Philip, Principles of International Insolvency Law, (Sweet & Maxwell, 1995).
- Wood, Philip, Title Finance, Derivatives, Securitisations, Set-off and Netting, (Sweet & Maxwell, 1995).

- Wright, W Jerry, Business and Economic Development in Saudi Arabia, (Macmillan Press Ltd, 1996).
- Ziegel, Jacob et. al., New Developments in International Commercial and Consumer Law, (Hart Publishing, 1998).
- Zonk, Neal, et. al, Reforming Financial Systems: Policy Change and Privatisation, (Greenwood Press, 1991).

Selected References in Arabic

- Abdu, Abdul El-Majeed, *Al-Nizam Al-Banki fi Al-Mamlka*, (M'ahad Al-Edarah Al-'Aama, 1988). [The Banking System in Saudi Arabia].
- Abdu, Abdul El-Majeed, *Al-Kafalat Al-Bankkya fi Al-Mamlka*, (M'ahad Al-Edarah Al-'Aama, 1990). [Banking Guarantees in Saudi Arabia].
- Abdul Jawad, Muhmmad, *Buhuth fi Al-Shari'a wa Al-Qanun*, , (Munshat Almaref, 1977), [Essays in Islamic *Shari'a* and Law].
- Abdul Jawad, Muhmmad, *Al-Tatwor Al-Tashre'ae fi Al-Mamlka*, (Munshat Almaref, 1977) [The Legislative Development in the Kingdom of Saudi Arabia].
- Abu Al-Rish, Muhammad, *Bayan Madhahib Al-Fuqaha Fi 'Aqd Al-Rahn*, (Matba'at Al-Amanah, 1986).[Explanation of the Islamic Schools in relation to the *Rahn* contract].
- Al -Sanhuri, Abdul Raziq, *Masader Al-Haq fi Al-Fiqh Al-Islami,*(1967). [Sources of Rights in Islamic *Fiqh*].
- Al-Kateeb, Mahmood, *Mabadea Al-Munza'at Al-Masrefeyah,* (Dar Al-Kateeb, Saudi Arabia). [Rules of Banking Disputes Settlement in the Kingdom Of Saudi Arabia].
- Al-Qari, Ahmed, *Majalat Al-Ahkam Al-Shri'yah,* (Tihama Publications, 1981).
- Al-Sanhuri, Abdul Raziq, *Al-Wasit Fi Sharh Al-Qanun Al-Madani Al-Jadid,* (1950). [Explanation of the Civil Law]
- Azab, H., *Al-Nizam Al-Tijari Al-Saudi,* (Dar Al-Nahda Al-Arabia). [Commercial Regulations in Saudi Arabia].

- Azab, H., *Nizam Al-Sharikat Al-Saudi*, (Dar Al-Nahda Al-Arabia). [Company Regulations in Saudi Arabia].
- Barshumi, Abd al-Fattah, *Al-Rahn Wa Al-Shuf'ah Fi Al-Fiqh Al-Islami*, (Dar Al-Taba'ah Al- Muhmmadiyah, 1988). [*Rahn and Pre-emption in Islamic Fiqh*]
- H. Abdul Al-Mun'aem, *Diwan Al-Mazalem*,(Dar Al-Shurooq, 1983). [Board of Grievances].
- Hamad, N., *Al-hiyaza fi Al-'aqoud fi Al-fiqh Al-Islami*, (Maktebet Dar Lebanon, 1978). [Possession in the Contracts in the Islamic *Fiqh*].
- Hamad, N., *Dirasat fi Asoul Al-Mudaynat fi Al-fiqh Al-Islami*, (1990). [Studies in the Principles of Borrowing in Islamic *Shari'a*].
- Kharofa A., *'Aqd Al- Qard fi Al-Shari'a Al-Islamiya*, (Moasast Nofel, 1982). [Loan Contract in Islamic *Shari'a*].
- Qasem, Ali, *Tasurfat Al-adl Fi Al-Marhon*, (Dar Al-Jama'a Al-Jadida, 2002). [Adl's Dealings with the Secured Asset].
- Sheikh, Hassan, *Al-Tanzeem Al-Qdhai fi Al-Mamlka*,(Tihama, 1983). [Judicial Regulation in Saudi Arabia).

Articles, Papers and Chapters

- Abdi Dualeh, Suleiman, '*Islamic Securitisation: Practical Aspects', available at* http:www.guidancefinancial.com.
- Adam, Nathif, et. al., Islamic Bonds: Your Guide to Issuing, Structuring and Investing in *Sukuk*, (Euromoney, 2004).
- Affaki, Georges, *Demand Guarantees in the Arab Middle East*, 7 J.I.B.L 271, (1997).
- Ajani, Gianmaria, *'By Chance and Prestige: Legal Transplants in Russia and Eastern Europe'*, The American Journal of Comparative Law, 1995, 43, 93.
- Alameldin, M, *' Banking Disputes in Saudi Arabia'*, 10 IFLR 36, (1991).

- Al-Amine, Muhammad, *'Istisna, and its application in Islamic Banking'*, ALQ, (2001), 16(1), 22.
- Al-Amine, Muhammad, *'The Islamic Bonds Market: Possibilities and Challenges'*, International Journal of Islamic Financial Services, ..., 3(1), ...
- Alderdic Paul, et. al., *'Risk Finance for Project Finance: The Expanding Horizon of Credit Enhancement'*, The Journal of Structured and Project Finance (2001), 6(4), 30.
- Al-Fattah, Nabil Abd, The Anarchy of Egyptian Legal System: Wearing Away the Legal and Political Modernity, in Legal Pluralism In The Arab World, at 159 (Baudouin Dupret et al. eds., Kluwer Law International, 1999).
- Ali, A, *Set Standards for Islamic Banks, Says IDB,* 57 Islamic Banker 6, (2000).
- Alles, Lakshman, Asset Securitisation and Structured Financing: Future Prospects and Challenges for Emerging Market Countries, (IMF Working Paper, 2001).
- Al-Rimawi, Lu'Ayy, *'Middle East: Islamic Models of Equity Markets'*, Company Lawyer, 2000, 21(5), 161.
- Al-Saeed, Masour, *'Legal Protection of Economic Development Agreements'*, ALQ, (2002), 17(2), 150.
- Ambinder, Loren, et. al., *'The Mirage Becomes Reality: Privatisation and Project Finance Developments in the Middle East Power Market'*, 24 Fordham International Law Journal 1029, (2001).
- Amison, Martin, *'BOT Will Power Middle East Project Growth'*, 16 I.F.L.Rev15, (1997).
- Amison, Martin, *'Privatisation and Project Finance in the Middle East'*, IFLR, (1995) XIV (11), 14.
- Amison, Martin, *'Privatisation and Project Finance in the Sultanate of Oman'*, Yearbook of Islamic and Middle Eastern Law, (1994), Volume 1, 109.

- Amison, Martin, *Privatisation and Project Finance in the Middle East*, 14 I.F.L.Rev 14, (1995).
- Angell, Nicholas, *Impact of the GCC on the Developing Legal Systems of the Gulf Countries, in* The Gulf Cooperation Council: Moderation And Stability In An Independent World, at 112 (John Sandwick ed., Westview Press, 1987).
- Antoine, Nasri and BSEC Bemo Securitisation, *'MENA – GCC Securitisation Market Review'*, 2 *available at* http://www.bemosecuritisation.com.
- Appiah, J D, *'Infrastructure Projects: BOT Projects Developed Country Structuring'*, International Business Lawyer, (1991), 19, 206.
- Arkins, Jonathan, *'Ok – So You've Promised, Right? The Negative Pledge Clause and the Security it Provides'*, J.I.B.L, (2000), 198.
- Arner, Douglas, et. al., *The East Asian Financial Crisis: 1997- 1998, in* Financial Crises in the 1990s: Sir Joseph Gold Memorial Series Vol. 4 (BIICL, 2001).
- Badawi, Zaki, *'Arabian Winds of Change'*, 37 Islamic Banker 16, (1999).
- Badawi, Zaki, *'Debt Trading and Securitisation'*, 3 Islamic Banker 20, (1996).
- Badawi, Zaki, *A Consensus Too Far?*, 7 Islamic Banker 19, (1996).
- Badawi, Zaki, *A Harvard Madhab of Islamic Law?* 41 Islamic Banker 16, (1999).
- Badawi, Zaki, *A Market with a Conscience*, 10 Islamic Banker 20, (1996).
- Badawi, Zaki, *A New Role for Shariah Boards*, 24 Islamic Banker 18, (1998).
- Badawi, Zaki, *Codifying Fiqh Al-Muamalat*, 61 Islamic Banker 14, (2001).
- Badawi, Zaki, *Leading the Way Convergence in Compliance*, 58/59 Islamic Banker 24, (2000).
- Badawi, Zaki, *Which Banking System –Dual or Single?* 34 Islamic Banker 16, (1998).
- Bakheet, Beshr *'Developing GCC Stock Market: The Private Sector Role'*, Middle East Policy Council Journal, 1999, 6(3).

- Ballantyne, William, Commercial Law in the Arab Middle East: The Gulf States, at 122 (Graham&Trotman, 1992).
- Ballantyne, Williame, *'Syndicated loans'*, Arab Law Quarterly, 1996, 372.
- Banakar, R. and M. Travers, An Introduction to Law and Social Theory, (Hart Publishing, 2002, Oxford).
- Bank for International Settlements, The Banking System in Emerging Economies: How Much Progress Has Been Made? BIS Papers No. (28), August (2006).
- Bank of International Settlement, Basel Committee Report on Asset Transfers and Securitisation (September 1992).
- Bazinas, Spiro, An International Legal Regime for Receivables Financing: UNCITRAL's Contribution, 8 Duke J. Comp & Int'l L 315, (1998).
- Bazinas, Spiros, Multi-Jurisdictional Receivables Financing: UNCITRAL's Impact on Securitisation and Cross-Border Perfection, 12(2) Duke J. Comp & Int'l L 365, (2002).
- Beale, Chris, et. al, *' Credit Attributes of Project Finance'*, The Journal of Structured and Project Finance (2002), 8(3), 5.
- Beardsworth, John, *'Negotiating Power Purchase Agreements: Fundamentals for Risk Allocation and Dispute Resolution'* in Project Financing from Domestic to International: Building Infrastructure Projects in Developing Markets, (1995), (PLI Comm. L. & Practice Course Handbook Series, No. A4-4460), 27.
- Beer, Carl Bjerre, *' Project Finance, Securitisations and Consenuality'*, Duke J. Comp. & Int'l L, (2002), 12, 411.
- Belder, Richard, *'Shari'a Related Documentary Issues in Islamic Project Finance Transactions'*, Journal of International Banking Law and Regulation, (2003), 18(8), 317.
- Belmontes, Manuela, Using the Cayman Islands and other Offshore Jurisdictions for Securitisation Transactions, 10(2) J. Structured Fin 36, (2004)

- Benda-Beckmann, F., *'Who's Afraid of Legal Pluralism'*, Journal of Legal Pluralism and Unofficial Law, 2002, 47, 37.
- Berschasky, Arial, *' Innovative Financial Securities in the Middle East: Surmounting the Ban on Interest in Islamic Law'*, 9 University of Miami Business Law Review 107, (2001).
- Bidin, Aishah, Islamic Banking in Malaysia: Reconciling Religious Law and the Common Law, 1(4) J. Of Int'l Bank. Reg. 75, (2000)
- Bidin, Aishah, The Impact of Islamic Law in the Banking and Financial Market: A Malaysian Perspective, 22(5) Company Lawyer 154, (2001).
- Bidin, Aishan, *'The Impact of Islamic Law in the Banking System and Financial Market: A Malaysian Perspective', 22(5)* Company Lawyer 22(5), (2001).
- Bilal, Gohar, Islamic Finance: Alternatives to the Western Model, 23 Fletcher. F. World Aff. 145, 156, (1999).
- Bjerre, Carl, *' International Project Finance Transactions: Selected issues under Revised Article 9'* American Bankruptcy law Journal, (1999), 261.
- Blumental, David, *'Sources of Funds and Risk Management for International Energy Projects'*, Berkeley J, Int'l L, 16, 267.
- Boustany, Iad, *'Market Review for the MENA/GCC Region'*, 75, in Global Securitisation Review (2003-2004) (Euromoney).
- Boustany, Iad, et. al., *Islamic and Conventional Securitisation: Challenges and Opportunities for SMEs*, 2, in Global Securitisation Review (2004-2005) (Euromoney Yearbooks)
- Bowman, Lousie, *'Saudi's True-Sale Vehicle'*, International Securitisation Report, 2004, Issue 87, 24.
- Bradley, Mark *'Insolvency and Syndicated Lending'*, 13 J.I.B.L 19, (1997).
- Brealey, Richard, et. al, *'Using Project Finance to Fund Infrastructure Investments'*, Journal of Applied and Corporate Finance, (1996), 9(3), 25.

- Buckley, Ross, *The Law of Emerging Markets Loan Sales: Part 1,* 14(4) J.I.B.L 110, , (1999)
- Budd, Nicholas, *'What Basel II Means for Specialised Lending'*, IFLR, (2003), 22(2), 23.
- Butt, Simon, *'Intellectual Property in Indonesia: A Problematic Legal Transplant'*, European Intellectual Property Review, 2002, 24(9), 429.
- Caprio, Gerard D. Folkerts-Landau & T. Lane, Building Sound Finance in Emerging Market Economics: Proceedings of a Conference held in Washington, D.C June 10-11, (IMF– World Bank, 1993).
- *Carvan I Sukuk* : The First *Shari'a* Compliant Securitisation (Workshop – Securitisation World April 2005- Part I), *available at* http://www.bemosecuritisation.com
- *Carvan I Sukuk* : The First *Shari'a* Compliant Securitisation (Workshop – Securitisation World April 2005- Part II) *available at* http://www.bemosecuritisation.com
- Chaterjee, Charles, *' The Reality of Risks in Private Foreign Investment'*, 1 ICCLR 22, (1996).
- Chatterjee, Charles, *'Legal Aspects of Syndicated Loan Agreements'*, 9 Company Lawyer 91, (1988).
- Chatterjee, Charles, *'Procedural Aspects of Project Finance',* JIBL, (1993), 8(10), 421.
- Chinoy, Sajjid *Interest –Free Banking: The Legal Aspects of Islamic Financial Transactions,* 10 J.I.B.L 517, (1995).
- Chowdhury, M, *'Financing Real Assets the Sukuk Way'*, 98 Islamic Banker 8, (2004).
- Cohen, Neil, *'Credit Enhancement in Domestic Transactions: Conceptualising the Devices and Reinventing the Law'*, 22 Brook. J. Int'l L. 21, (1996- 97).

- Cohen, Neil, *'Harmonising the Law Governing Secured Credit: The Next Frontier'*, 33 Tex. Int'l. L.J 173, (1998).
- Cohen, Neil, *'Internationalising the Law of Secured Credit: Perspectives from the U.S Experience'*, University of Pennsylvania Journal of International Economic Law, (1999), 20(3), 423.
- Coiley, James, *'New Protections for Cross- Border Collateral Arrangements: Summary and Analysis of Draft E.U. Directive on Financial Collateral'*, JIBL, (2001), 16(5), 119.
- Connors, Jane, *Towards a System of Islamic Finance in Malaysia, in* Islamic Law and Finance, 57, at 58 (C. Mallat ed., Graham & Trotman, 1988).
- Country Finance: Malaysia, The Economist Intelligence Unit Limited (January - 2003).
- Country Finance: Saudi Arabia, The Economist Intelligence Unit Limited (January - 2004).
- Cuming, Ronald, *Modernising the Secured Financing Law of Developing Nations, with Particular Focus on the West Bank and Gaza, in* New Developments in International Commercial and Consumer Law, (J. Ziegel et. al. eds., Hart Publishing, 1998).
- Cuthbert, Neil, *'Direct Agreements Precedent'*, 16 INTBFL 22, (1997).
- Cuthbert, Neil, *'Security for Projects: Part (1)'*, 16 INTBFL 118, (1998).
- Cuthbert, Neil, *'Security for Projects: Part (2)'*, 16 INTBFL 128, (1998).
- Cuthbert, Neil, *'Security for Projects: Part (3)'*, 17 INTBFL 4, (1998).
- Davis, Henry, *'How Enron Has Affected Project Finance'*, The Journal of Structured and Project Finance (2002), 8(1), 19.
- Dewar, John, *'Yanpet: Largest Petrochemical Plant Financing'*, 17 I.F.L.Rev 7, (1998).

- Doty, Kirsten, *"Economic Legal Reforms as a Necessary Means for Eastern European Transition into the Twenty-First Century"*, 33(1), The International Lawyer 194, 1999.
- Duffet, Christopher, *'Using Trusts in International Finance and Commercial Transactions'*, 1, J. Int'l Trust and Corporate Planning, 23 (1992)
- Dymond, Christopher, *'Value Recovery After a Default: The Project Finance Perspective'*, The Journal of Structured and Project Finance (2003), 9(1), 14.
- EC/IS Report, Joint Task Force, Shaping a Market –Economy Legal System (European Economy No.2, 1993).
- Editorial, *A Consensus Too Slow,* 46 Islamic Banker 2, (1999).
- Editorial, *A Very Saudi Corporate Identity Crisis*, 101 Islamic Banker 2, at 2, (2004).
- Editorial, *Banking Models: Dual Boost for the Gulf*, 18 Islamic Banker 2, at 2 (1997).
- Editorial, *IMF Warms to Islamic Finance,* 45 Islamic Banker 10, (1999).
- Editorial, *New International Financial Architecture: Tempering Rhetoric with Reality*, 40 Islamic Banker 2, (1999).
- Editorial, *Should Shari'a Advisories be Regulated*, 83 Islamic Banker 2, (2003).
- Editorial, *Stagnation Threatens Islamic Banking Regulation,* 52 Islamic Banker 2, (2000).
- Editorial, *Takaful Firms Penetrate Saudi Market,* 53 Islamic Banker 2, (2000).
- Editorial, *Throwing Down the Gauntlet to SAMA,* 2 Islamic Banker 2, (1995).
- Editorial, *To Merge or Not to Merge,* 28 Islamic Banker 2, (1998).
- Editorial, *Voluntary Adoption Challenge for IFSB*, 80 Islamic Banker 2, (2002).
- El-Gamal, Mahmoud, *Interest and the Paradox of Contemporary Islamic Law and Finance*, Fordham International Law Journal, (2003), 27, 108.

- El-Hawary, Dahila et. al, Regulating Islamic Financial Institutions: The Nature of the Regulated, World Bank Policy Research Working Paper No. 3227, March 2004,
- El-Hawary, Dahlia, et. al., Regulating Islamic Financial Institutions: The Nature of the Regulated, World Bank Policy Research Working Paper 3227, March 2004.
- Elias, R., *'Legal Aspects of Swaps and Collateral'*, Journal of International Financial Markets, (2001), 232.
- Encyclopaedia of Islamic Banking and Insurance, 67, Institute of Islamic Banking and Insurance, 1995).
- Esty, Benjamin, *'The Equate Project: An Introduction to Islamic Project Finance'*, The Journal of Structured and Project Finance, (2000), 5(4), 7.
- Esty, Benjamin et. al., *'Creditor Rights, Enforcement and Debt Ownership Structure: Evidence from the Global Syndicated Loan Market'*, JFQA, (2003), 38(1), 37.
- Ewald, William, *'Comparative Jurisprudence (II): The Logic of Legal Transplants'*, American Journal of Comparative Law, (1995), 489.
- Fabozzi, Frank, 'A Primer on Securitisation', The Journal of Structured and Project Finance, 2003, 9(2), 5.
- Fahl, Rima, *'Assignment of Contract Proceeds'*, ALQ, (2002), 17(2), 198.
- Ferran, Ellis, *' Floating Charges – The Nature of the Security'*, 47 CLJ 213, (1998).
- Fine, Alison, *' Dealing Away Risk in Foreign Infrastructure Investment'*, The Journal of Structured and Project Finance (2003), 9(2), 53.
- Fitzgerald, Peter, *'Overview of Risks in International Financing'*, in Project Financing 1999: Building Infrastructure Project in Developing Markets, (1995), (PLI Comm. L. & Practice Course Handbook Series, No. (A4-4460), 7.
- Fleisig, Heywood, *'The Power of Collateral: How Problems in Securing Transactions Limit Private Credit for Movable Property'*, Pub.Pol'y for Private Sector, (1995), no.43.

- Forrester, Paul, *'Project Finance Collateralised Debt Obligations: What? Why? Now?'*, The Journal of Structured and Project Finance, (2002), 8(3), 37.
- Foster, Nicholas *'Transfers of Rights and Obligations in the UAE: A Comparative Analysis in the Light of English Law, French Law and the Shari'a'*, Yearbook of Islamic and Middle Eastern Law, (2000-2001), 7, 3.
- Foster, Nicholas, *'Commercial Security over Movables in the UAE: A Comparative Analysis in the Light of English Law, French and the Shari'a'*, Yearbook of Islamic and Middle Eastern Law, (1997- 1998), 4, 3.
- Foster, Nicholas, *'The Legal Structure of Islamic Law of Real Security'*, ALQ, (2000), 131.
- Frankel, Tamar, *'Cross-Border Securitisation: Without Law But Not Lawless'*, 8 Duke J. Comp. & Int'l L. 255, (1998)
- Giovanoli, Mario, *A New Architecture for the Global Financial Market: Legal Aspects of International Financial Standards Setting, in* International Monetary Law: Issues For The New Millennium, (Mario Giovanoli ed., Oxford University Press, 2000).
- Goode, Roy, *Security in Cross-Border Transactions,* 33 Tex. Int'l L. J. 47, (1998).
- Goode, Roy, The Changing Nature of Security Rights, *in* Emerging Financial Markets and Secured Transactions, (Joseph Norton et al. eds., Klwuer Law International, 1998)
- Gray, Cheryl, *'Evolving Legal Framework for Private Sector Development in Central and Eastern Europe'*, World Bank Discussion Paper No. 209, 1993.
- Griffiths, John, *'What is Legal Pluralism'*, Journal of Legal Pluralism, 1986, No.24, 1.
- Guislain, Pierre, *'Divestiture of State Enterprises: An Overview of the Legal Framework'*, (World Bank Technical Paper No. 186, 1992).

- Hamilton, Michael D. Davis & T. DeJongh, *'Project Finance for Petrochemicals in Saudi Arabia'*, Project Finance International, 2001/April, Issue 215, 63.
- Hamzeh, Nizar, *'Qatar: The Duality of the Legal System'*, Middle Eastern Studies, 1994, 30(1), 79.
- Han, Mei, et. al., *' How to Assess the Profitability of a Project Finance Deal: From the Lenders' Perspective'*, Journal of Project Finance, (1997), 3(4), 21.
- Harris, Clive, et. al., *'Infrastructure Projects: A review of Cancelled Private Projects'*, Pub.Pol'y for Private Sector, Note No. 252, (2003).
- Hayes, Ellen, et. al., *'Taming the Risks of Project Finance, Part One: Corruption and Legislative Reform'*, IFLR, (2001), 20(5), 27.
- Hayes, Ellen, et. al., 'Taming the Risks of Project Finance, Part Two: Political Risk and Insurance', IFLR, (2001), 20(6), 17.
- Herbiet, Michel, *The Constitutional Basis of the Economic Order During a Period of Transition from a Planned Economy to a Market Economy, in* Rule of Law and Transition to a Market Economy: Proceedings of the UniDem Seminar organised in Sofia on 14-16 October 1993, (European Commission for Democracy through Law, Council of Europe Press, 1994)
- Hill, Enid, *'Comparative and Historical Study of Modern Middle Eastern Law'*, The American Journal of Comparative Law, 1977-1978, 26, 279.
- Hoberbeck, Andreas, *'Insurance under Saudi Arabian Law'*, Lloyd's Maritime and Commercial Law, 1986, Check Volume (2), 246.
- Hoffman, Scott, *'A Practical Guide to Transactional Project Finance: Basic Concepts, Risk Identification and Contractual Considerations'*, 45 The Business Lawyer 181, (1989).
- Hourani, Hasam, et. al, *'Securities Law in the United Arab Emirates'*, ALQ, (2001), 16(1), 55.
- Hudson, D, *The Pitfalls of Agency,* 26 Islamic Banker 9, (1998).

- Hughes, Martin, *Loans Agreements –Single Bank and Syndicated*, 15 J.I.B.F.L 155, (2000).
- Huneidi, Isa, *'The Legal Aspects of Doing Business in Kuwait'*, International Company and Commercial Law Review, (1991), 2(12), 403.
- Hurlock, Matthew *'New Approaches to Economic Development: The World Bank, The EBRD and the Negative Pledge Clause'*, Harvard International Law Journal, 1994, 345.
- International Structured Finance: Special Report, Saudi Arabia - The Legal Environment and Implications for Structured Finance Transactions, (30 Nov 2000, Moody's Investors Service).
- Islamic Capital Market Fact Finding Report, Report of the Islamic Capital Market Task Force of the International Organisation of Securities Commission, July 2004.
- Jerry Wright, Islamic Banking in Practice: Problems in Jordan and Saudi Arabia, (1995.
- Johnaston, B., *'Project Finance'*, International Business Lawyer, (1997), 25, 374.
- Johnston, B, *'Project Finance'*, 25 International Business Lawyer 374, (1997).
- Kahn-Freund, 'On Uses and Misuses of Comparative Law', 37(1) Mod. L. Rev. 1, (1974).
- Kahn-Freund, *'On Uses and Misuses of Comparative Law'*, Modern Law Review, 1974, 37(1), 1.
- Kamil, [???], *Factoring Through Musharaka: A Liquidity Mechanism for Entrepreneurs*, 18 Islamic Banker 12, (1997).
- Kargman, Steven, *'Project Finance Restructuring and Corporate debt Restructuring in the Emerging Markets: A Comparative Overview'*, The Journal of Structured and Project Finance (2003), 8(4), 35.
- Karim, Ahmed, International Accounting Harmonisation, Banking Regulation, and Islamic Banks, 36 (2) The Int'l J. of Accounting 169, (2001).

- Keeley, Patrick *Project Financing for International Independent Power Facilities: Management of Risks'*, 14 Journal of Energy & Natural Resources Law 445, (1996).
- Khan, Mansoor *'Designing and Islamic Model for Project Finance'*, 16 I.F.L. Rev 13, (1997).
- Khan, Nadim, *'Islamic Financing and Securitisation'*, FITAR, 2001, 6(2), 413.
- Khan, Nadim, *Islamic Financing and Securitisation*, 6(2) FITAR 413, (2001).
- Khuan, Annie, *'Islamic Insurance in Malaysia: A Successful Model in Operation'*, International Insurance Law Review, 1998, 6(3), 79.
- Klarmann, Reinhard, *'Construction and Lease Financing in Islamic Project Finance'*, J.I.B.L.R, 2004, 19(3), 61.
- Klompjan, Richard, et. al., *' Default Risk in Project Finance'*, The Journal of Structured and Project Finance (2002), 8(3), 10.
- La Porta, R. *'Legal Determinants of External Finance'*, 52 Journal of Finance 1131, (1997)
- Ladbury, Rick *'Recent Trends in Limited Recourse Financing with Particular Reference to Limited Recourse Loans, Production Payments and Forward Sale and Purchase Agreements'*, Australian Mining and Petroleum Law Journal, (1979), 2(1), 68.
- Ladbury, Rick, et. al, *'Current Legal Problems in Project Financing'*, Australian Mining and Petroleum Law Journal, (1981), 3(1), 139.
- Laryea, Thomas, *Development of Standards for Security Interests*, (IMF Legal Department, 2003) *available at* http://www.imf.org.
- Lastra, Rosa *'The International Monetary Fund in Historical Perspective'*, Journal of International Economic Law, 2000, 3(3), 507.
- Lastra, Rosa, *'IMF Conditionality'*, *in* International Monetary and Financial Law upon Entering the New Millennium: Sir Joseph Gold Memorial Series Vol. 1, (Joseph Norton and Mads Andenas eds., BIICL, 2002).

- Latif, Qadeer, *'Security Over Real Property in the Kingdom of Saudi Arabia'*, The Law Firm of Yousef and Mohammed Al-Jadaan, *available at*
- Lee, Eric, *'The Islamic Approach to Insurance'*, IFLR, 1985, IV (3), 31.
- Lighterness, Tony, *'A Borrower's View of Project Lending'*, BJIBFL, (1993), 8(7), 344.
- Lipton, Jacqueline, *'Intellectual Property in the Information Age and Secured Finance Practice'*, European Intellectual Property Review, (2002), 358.
- M. Davis, *A Brief Presentation of the Construction of a Waste Treatment Plant from the Lender's Perspective*, 12 Const. L. J 218, (1996).
- Macartney, Adrienne, *'Qatar Liquefied Gas Company Limited ("Qatargas"): The Downstream Project – a Case Study'*, Yearbook of Islamic and Middle Eastern Law, (1996), Volume 3, 51.
- Machlin, Barry, *' Lessons Learned from Troubled Projects: Indonesia'* in Project Financing 1999: Building Infrastructure Project in Developing Markets, (1999), (PLI Comm. L. & Practice Course Handbook Series, No. (A0-001N), 457.
- Mallat, Ghilbli, The Debate on Riba and Interest in Twentieth Century Jurisprudence, in Islamic Law and Finance, 69 (Ghilbli Mallat ed., Graham & Trotman, 1988).
- Marar, Amr, The Co-operation Council for the Arab States of the Gulf, 10(3) Law and Business Review of the Americas 475, (2004). \
- Marray, Michael, *'Sukuk and See'*, Project Finance, Dec 2003/Jan 2004, Issue 246, 24.
- Marrese, Michael, Transformation of Planned Economics: Property Rights Reform and Macroeconomic Stability, (OCED,1991).
- Martin, Jeremy, *Security in Islamic Banking, in* European Perceptions of Islamic Banking, (Institute of Islamic Banking and Insurance, 1996).

- Mattie, Ugo, *'Efficiency in Legal Transplants: An Essay in Comparative Law and Economics'*, International Review of Law and Economics, 1994, 14, 3.
- Mauel, John, *'Common Contractual Risk Allocations in International Power Projects'*, Columbia Business Law Review, (1996), 37.
- Maysami, Ramin, et. al., One Country, Two Systems: Banking in Malaysia, 13(7) JIBL 233, (1998)
- McBarnet, Doreen, *Transnational Transactions: Legal Work, Cross-Border Commerce and Global Regulation, in* Transnational Legal Processes, (Michael Likosky et al. eds., Butterworths, 2002)
- McCormack, Gerard, et. al., *'The EBRD Model Law on Secured Transactions: Comparisons and Convergence'*, 3 CFILR 65, (1998).
- McCormick, Roger, *' Project Finance: Legal Aspects: Part 1'*, BJIBFL, (1992), 7(8), 373.
- McCormick, Roger, *'Project Finance: Legal Aspects: Part 2'*, BJIBFL, (1992), 7(9), 428.
- McMillen, Michael, *Islamic Sharia' ah – Complaint Project Finance Collateral Security and Financing Structure Case Studies'*, Fordham International Law Journal, (2001), 24,1184.
- McQuiston, Raymer, *'Drafting an Enforceable Guaranty in an International Financing Translation: A Lender's Perspective'*, 10 International Taxation and Business Law 138 , (1993).
- Merry, Sally, *'Legal Pluralism'*, Law and Society Review, 1988, 22(5), 869.
- Mertus, Julie, *'From Legal Transplants to Transformative Justice: Human Rights and the Promise of Transnational Civil Society'*, American University International Law Review, 1999, 1335.

- Methold, Graham, et. al., *Saudi Law Cogent Cogen: Tihama Cogen's Structure Combines Both English and Saudi Security Law without being Cumbersome*, 250 Project Fin. & Infrastructure Fin. 51, (2004).
- Mettala, Kimmo, *Governing – Law Clauses of Loan Agreements in International Project Financing*, 20 The International Lawyer 219, (1986).
- Meyer-Reumann, Rolf, *'The Banking System in Saudi Arabia'*, 10 ALQ 207, (1996).
- Mistelis, Loukas, *'Regulatory Aspects: Globalisation, Harmonisation, Legal Transplants, and Law Reform – Some Fundamental Observations'*, International Lawyer, 2000, 1055.
- Mubaydeen, Ibrahim, *' Legal Aspects of Project Finance Transactions under the Laws of the United Arab Emirates'*, Journal of International Banking Law and Regulation, (2003), 18(5), 219.
- Nader, F., *'The Legal Structure of Islamic Finance and Privatisation'*, Yearbook of Islamic and Middle Eastern Law, (1995), Volume 3, 32.
- Naser, K., *'The Juridical Basis of the Floating Charge'*, 15 The Company Lawyer 11, (1994).
- Nasser, Nagla, *' Project Finance, Public Utilities, and Public Concerns: A Practitioner's Perspective'*, 23 Fordham International Law Journal 60, (2000).
- Nicklisch, Andreas, *'Realisation of Privately Financed Infrastructure Projects – Economic Viability, Contract Structure , Risk Management'*, ICLR, (2003),20(1),81.
- Norman, Trevor, *Securitisation Structures within an Islamic Framework,* 102 Int'l Securitisation Rep 21, (Supp. 2005).
- Norton, Joseph, *International Co-operative Efforts and Implications for Law Reform,* in, Bank Failures and Bank Insolvency Law in Economies in Transition, at 296 (Rosa Lastra et al. eds., Kluwer Law International, 1999).
- Norton, Joseph, International Financial Institutions and the Movement toward Greater Accountability and the Case of Legal reform Programmes and the Problem

of Evaluation, in International Monetary and Financial Law upon Entering the New Millennium: Sir Joseph Gold Memorial Series Vol. 1, (Joseph Norton and Mads Andenas eds., BIICL, 2002).

- Norton, Joseph, *The New International Financial Architecture and Global Banking Institutions, in* International Financial Sector Reform: Standard Setting And Infrastructure Development, (Say Goo et al. eds., Kluwer Law International, 2002)
- O'Neil, Charles, *'Project Financing Lending Criteria'* in Project Financing 1989: Power Generation, Waste Recovery, and Other Industrial Facilities, (1989) (PLI Real Est. L. & Practice Course Handbook Series, No. N4-4507), 299.
- O'Sullivan, John, *'Chadbourne & Parke LLP: Project Financing Techniques'*, in Project Financing 1999: Building Infrastructure Project in Developing Markets, (1999), (PLI Comm. L. & Practice Course Handbook Series, No. (A0-001N), 61.
- Othman, T, *'The Primary Case for a Secondary Market'*, 98 Islamic Banker 6, (2004).
- Pardy, Robert, *'Institutional Reform in Emerging Securities Market'*, World Bank Working Paper May 1992.
- Park, Edward, *'Allowing Japanese Banks to Engage in Securitisation: Potential Benefits, Regulatory Obstacles, and Theories for Reform'*, U. Pa. J. Int'l Econ. L., 17, 723 (1996).
- Parker, M, *Bahrain Meeting's Challenge for Central Banks,* 49 Islamic Banker 8, (2000).
- Parker, Mushtak, *Alburaq Ascends Mortgage Ladder*, 100 Islamic Banker 18, (2004)
- Parker, Mushtak, *Clamouring for Regulation,* 32 Islamic Banker 6, (1998).
- Parker, Mushtak, *Expansion Fever Grips the Sector,* 44 Islamic Banker 6, (1999).
- Parker, Mushtak, *IFSB Designs for Islamic Financial Architecture*, 82 /83 Islamic banker 8, (2002).

- Parker, Mushtak, *Is Islamic Co-operative Insurance Islamic?*, 84 Islamic Banker 6, (2003)
- Parker, Mushtak, *Lloyds TSB Launches Islamic Current Account*, 108/109 Islamic Banker 16, (2005).
- Penrose, J., *'Project Finance Debt Rating Criteria'*, JIBL, (2001), 16(8/9), 219.
- Penrose, James, *'Special-Purpose Entities in Project Finance Transactions'*, The Journal of Structured and Project Finance, 1996, 2(3), 58.
- Penrose, James, *'Special–Purpose Entities in Project Finance Transactions'*, Journal of Project Finance, (1996), 2(3), 58.
- Penrose, James, et.al., *'Securitisations of "New Asset" Classes: A Rating Approach'*, The Journal of Structured Finance, 2004, 10(2), 20.
- Pierie, David, *'Contractual Problems Connected with Major Infrastructure Projects'*, 12 International Construction Law Review 213, (1995).
- Plehn, Robert, *'Securitisation of Third World Debt'*, Int'l Law, 1989, 23, 161.
- Porta, Rafael, et. al, *'Which Countries Give Investors the Best Protection?'*, Pub.Pol'y for Private Sector, Note No. 109, (1997).
- Porter, Andrew, *'Security Issues in North Sea Financings'*, 11 OGLTR 271, (1986/87).
- Posner, Richard, *'Creating a Legal Framework for Economic Development'* 13(I), The World Bank Research Observer 1 (1998).
- Pritchard, Robert, Economic Development, Foreign Investment and the Law: Issues of Private Sector Involvement, Foreign Investment and the Rule of Law in a New Era, (Kluwer Law International & International Bar Association, 1996).
- Rachagan, Shanthy, *Islamic Banking in Malaysia*, 20 (2) JIBLR 88, (2005)
- Rashed, Aba Namay, *'Recent Constitutional Reforms in Saudi Arabia' 42(2)*, International and Comparative Law Quarterly, 295, 1993.

- Rauner, Stewart, *'Project Finance: A Risk Spreading Approach to the Commercial Financing of Economic Development'*, 24 Harv. Int'l. L.J 145, (1983).
- Ray, Nicholas *'The Medieval Islamic System of Credit and Banking: Legal ad Historical Considerations'*, 12(1)ALQ43, (1997)
- Reddy, Michael, *'Emerging Markets of the Gulf: An Overview'*, JIBL, (1995), 10(5), 191.
- Reis-Roy, Calvin. *'Securitisation Structures in the U.S'*, 13 J.I.B.L 486, (1997)
- Report Of The G10 Working Party On Financial Stability In Emerging Market Economies, Financial Stability In Emerging Economies: A Strategy For The Formulation, Adoption And Implementation Of Sound Principles And Practices To Strengthen Financial Systems (April 1997).
- Report of the Working Party on Financial Stability in Emerging Market Economies: A Strategy for the formulation, adoption and implementation of sound principles and practices to strengthen financial systems (April 1997).
- Richards, Alan *"The Global Financial Crisis and Economic Reform in the Middle East'*, Middle East Policy Council Journal, 1999, 6(3).
- Ring, Malcolm, *'Islamic Funding and the Effect of Stamp Duty Land Tax'*, J.I.B.L.R, 2004, 19(5), 183.
- Rodgers, Alan, et. al., *'Independent Power Projects in Saudi Arabia'*, International Financial Law Review, (2000), 19.
- Rodrigues, Marisa, 'Riyality Bites', A Supplement to Project Finance, Dec 2003, 32.
- Rover, Alexander, et al., *A Primer on Securitisation*, 9(2) J. Structured & Project Fin. 5, (2003).
- Rule of Law and Transition to a Market Economy: UniDem Seminar Sofia, 14-16 October 1993 (Council of Europe Press, 1994).
- Saif, A *Exceptional Potential of Islamic Finance: Bahrain Calls Arab Funds Home,* 19 Islamic Banker 6, (1997).

- Salacuse, Jeswald, *The Legal Architecture of Emerging Markets, in* The Reform of the International Financial Architecture, 47, at 58. (Rosa Lastra ed., Kluwer Law International, 2001)
- Saudi Arabian Monetary Agency, "SAMA Globalisation: The Role of Institution Building in the Financial Sector : Case Staudy of Saudi Arabia– G20", 10 September 2003.
- Schacht, Joseph, *'Islamic Law in Contemporary States'*, The American Journal of Comparative Law, 1959, 8, 133.
- Schaik, Diederik, *'Islamic Banking'*, The Arab Bank Review, 2001, 3(1), 45.
- Schulze, Gunther et al., *Globalisation of the Economy and the Nation State*, 22(3) The World Economy 295, at 303, (1999).
- Schwarcz, Stephen, *'The Universal Language of Cross- border Finance'*, Duke J. Comp. & Int'l L, (1998), 8,235.
- Schwarcz, Steven, *'The Alchemy of Asset Securitisation'*, Stanford Journal of Law, Business & Finance, 1994, 1(1), 133.
- Semkow, Brian, *'Syndicating and Rescheduling International Financial Transactions: A Survey of the Legal Issues Encountered by Commercial Banks'*, 18 The International Lawyer 869, (1984).
- Sequeira, Shalini, *Syndicated Loans – Let the Arranger beware*, 1 BJIBFL 117, (1997).
- Shenker, Joseph, et al., Asset Securitisation: Evolution, Current Issues and New Frontiers, 69 Tex. L. Rev 1369, (1991).
- Sheppard, Robert, *'Capital Market Financing for Developing Country Infrastructure Projects'*, 2003, DESA Discussion Per No. 28.
- Shihata, Ibrahim, *'Some Trends in Banking Law and their Relevance to the GCC States'*, 13 ALQ 303, (1998).

- Shihata, Ibrahim, *'The Role of Law in Business Development'*, Fordham International Law Journal, 1997, June, 1577.
- Shihata, Ibrahim, *Good Governance and the Role of Law in Economic Development, in* Making Development Work: Legislative Reform for Institutional Transformation and Good Governance, at xvii (Ann Seidman et al. eds., Kluwer Law International, 1999).
- Shihata, Ibrahim, Some Observations on the Question of Riba and the Challenges Facing 'Islamic Banking, in Yearbook of International Financial and Economic Law (2000-2001), (Joseph Norton et al. eds., BIICL, 2003).
- Shimada, Yoshiki, *'Japanese Asset Securitisation: A Guide for Practitioners'*, Harv. Int'l L. J., 1997, 38, 171.
- Shimada, Yoshiki, et al., Japanese Asset Securitisation: A Guide for Practitioners, 38 Harv. Int'l L. J. 171, (1997).
- Short, Rodney, *'Export Credit Agencies, Project Finance, and Commercial Risk: Whose Risk is it, Anyway?'*, Fordham Int'l L. J, (2001), 24, 1371.
- Sigman, Harry, et al., Toward Facilitating Cross-Border Secured Financing and Securitisation: An Analysis of the United Nations Convention on the Assignment of Receivables in International Trade, 57Bus. Law. 727, (2002).
- Simpson, David, *'Loan Participations: Pitfalls for Participants'*, The Business Lawyer, (1976), 31, 1977.
- Simpson, John, et al., *General principles of a Modern Secured Transactions Law, in* Emerging Financial Markets and Secured Transactions, (Joseph Norton et al. eds., Klwuer Law International, 1998)
- Simpson, John, et. al., *'Ten Years of Secured Transactions reform'*, 16 BJIBF 5, (2001).
- Standard & Poors, *A Closer Look at Ijara Sukuk,* (2 February 2005) *available at* http://www.standardandpoors .com.

- Standard & Poors, Islamic Banking: A Unique Differentiation Strategy for Gulf Financial Institutions, (22 November, 2004) *available at* http://www2.standardandpoors.com
- Steinberg, Marc, *'Emerging Capital Markets: Proposals and Recommendations for Implementation'*, 30 International Lawyer 715, (1996).
- Stelwagon, William, *'Financing Private Energy Projects in the Third World'*, The Catholic Lawyer, 37, 45.
- Stewart-Smith, Martin, *'Private Financing and Infrastructure Provision in Emerging Markets'*, Law & Policy in International Business, (1994-1995), 26, 613.
- Susan, Creane, et. al, Financial Development in the Middle East and North Africa, (International Monetary Fund, 2003).
- Tamanaha, Brian, *'The Folly of the 'Social Scientific' Concept of Legal Pluralism'*, Journal of Law and Society, 1993, 20(2), 192.
- Tamanaha, Brian, *A Non-essential Version of Legal Pluralism*, 27Journal of Law and Society 296, 297, (2000).
- Tamanha, Brian *'A Non-Essentialist Version of Legal Pluralism'*, Journal of Law and Society, 2000, 27(2), 296.
- Teubner, Gunther, *'The Two Faces of Janus: Rethinking Legal Pluralism'*, Cardozo Law Review, (1991-1992), 13, 1443.
- The Development of Corporate Bond Markets in Emerging Market Countries: The Emerging Markets Committee of the International Organisation of Securities Commissions, May 2002.
- The World Bank, Principles and Guidelines for Effective Insolvency and Creditor Rights Systems, April (2001).
- Thieffry, Gilles & J. Walsh, *'Securitisation: The New Opportunities Offered by Economic and Monetary Union'*, J.I.B.L, 1997, 12, 463.

- Thieffry, Gilles, et al., Securitisation: The New Opportunities Offered by Economic and Monetary Union, 12 J.I.B.L 463, (1997).
- Thomas Certhers, *'The Rule of Law Revival'*, Foreign Affairs, 1998, 95.
- Tokley, Ian, *Cross Border Lending: International Banking Documents*, 10 J.I.B.L 233, (2000).
- Turner, Richard, *'FIDIC Conditions – Arabian Gulf Region'*, ICLR, (1992), 9(2), 140.
- Upham, Frank, *'Speculations on Legal Informality: On Winn's "Relational Practices and Marginalization of Law"'*, Law & Society Rev., 1994, 28, 283.
- USAID Policy Paper, *'Financial Markets Development'*, 1988.
- Vanderlinden, Jacques, *'Return to Legal Pluralism: Twenty Years Later'*, Journal of Legal Pluralism, 1989, 28, 149.
- Vogel, Frank, *Islamic Governance in the Gulf: A Framework for Analysis, Comparison, and Prediction, in* The Persian Gulf at the Millennium: Essays in Politics, Economy, Security, and Religion, 249, at 275-276 (Gary Sick et al. eds., Macmillan Press Ltd, 1997).
- Vogel, Frank, *Prospects for a Restatement: The Codification of Commercial and Contract Law in Saudi Arabia, in* Commercial Law In The Middle East, (H. Lewis et al. eds., Kluwer Law International, 1995).
- Waelde, Thomas, *'Legislative Reform in Transition Economics: Western Transplants – A Short- Cut to Social Market Economy Status?'*, 43 International and Comparative Law Quarterly 347, 1994.
- Walker, Gary *'The Law of Financial Conglomerates: The Next Generation'*, 30 INT'L LAW 57, 1996.
- Walker, George, *International Financial Crisis and the Financial Stability Forum, in* International Financial Sector Reform: Standard Setting And Infrastructure Development, (Say Goo et al. eds., Kluwer Law International, 2002)

- Wallenstein, Stephen, *'Situating Project Finance and Securitisation in Context: A comment on Bjerre'*, Duke J. Comp. & Int'l L, (2002), 12, 449.
- Walsh, Richard, *' Pacific Rim Collateral Security Law: What Happens When the Project Goes Wrong?'*, 4 Stanford Journal of Law , Business and Finance 115, (1998).
- Walters, Leonora, *'Unlikely Markets Show Appetite'*, International Securitisation Report, November 2002, Issue 72, 31.
- Walters, Leonora, et. al., F. Murra, *'A Helping Hand'*, International Securitisation Report, (Dec 2002-Jan 2003), Issue 73, 15.
- Warner, Waide et. al, *'Credit Agreements and Collateral Arrangements'*, in Project Financing 1999: Building Infrastructure Project in Developing Markets, (1995), (PLI Comm. L. & Practice Course Handbook Series, No. (A4-4460), 79.
- Warner, Waide, *'An Overview of International Project Financing'*, in Project Financing in Emerging Markets, (1996), (PLI Comm. L. & Practice Course Handbook Series, No. A4-4511), 7.
- Watson, Alan, *'Legal Transplants and Law Reform'*, LQR, 1976, 92, 79.
- Watson, Alan, Comparative Law and Legal Change, 37 Cambridge LJ313 (1978).
- Webb, Douglas, Legal System Reform and Private Sector Development in Developing Countries, in Economic Development, Foreign Investment and the Law: Issues of Private Sector Involvement, Foreign Investment and the Rule of Law in a New Era, 47 (Robert Pritchard, ed., Kluwer Law International and International Bar Association, 1996).
- Weist, D, *'Adapting Conventional ABS for Islamic Market'*, 72 Islamic Banker 8, (2002).
- Welsher, Ellen et al., Securitisations of "New Asset" Classes: A Rating Approach, 10(2) J. Structured Fin. 20, (2004).

- Wilson, Rodney, *Islamic Banking and its Impact on the International Financial Scene*, 10 J.I.B.L 437, (1995).
- Wilson, Rodney, *Islamic Banking in the United Kingdom,* 148 New Horizon 5, (2005)
- Wilson, Rodney, *The Issue of Interest and the Islamic Financing Alternatives*, J.I.B.L 23, (1998).
- Wilson, Rodney, *The Politics of Islamic finance*, 147 New Horizon 5, (2005).
- Woodman, Gordon, *'Ideological Combat and Social Observation'*, Journal of Legal Pluralism and Unofficial Law, 1998, 42, 21.
- Woodman, Gordon, *'Legal Pluralism and the Search for Justice'*, Journal of African Law, 1996, 40(2), 152.
- Worenklein, Jacob, *'The Global Crises in Power and Infrastructure: Lessons Learned and New Directions'*, The Journal of Structured and Project Finance (2003), 9(1), 7.
- Wynant, Larry, *'Essential Elements of Project Financings'*, The Banker, (1976), 77.
- Wynne, T, *Disclosure Key to Rating Islamic Banks,* 25 Islamic Banker 6, (1998).
- Yakcop, Nor, *Modelling Interest-Free Financial System: Avoiding Costly Errors The Malaysian Way,* 16 Islamic Banker 12, (1997).
- Yip, J, *Mobilising Islamic Finance for Infrastructure,* 25 Islamic Banker 14, (1998).
- Youssef, Y, *A Secondary Market of Primary Importance,* 47/48 Islamic Banker 14, (1999/2000).

Selected Webography

International and Multilateral

- International Monetary Fund http://www.imf.org.
- International Bank for Reconstruction and Development http://www.worldbank.org/
- World Trade Organisation http://www.wto.org/
- International Finance Corporation http://www.ifc.org
- European Bank for Reconstruction & Development http://www.ebrd.com
- Organisation for Economic Co-operation and Development http://www.oecd.org/
- Bank for International Settlement http://www.bis.org
- International Accounting Standards Board http://www.iasb.org.uk
- International Organisation of Securities Commissions http://www.iosco.org
- International Association of Insurance Supervisors http://www.iaisweb.org
- Financial Stability Forum http://www.fsforum.org
- Group of Seven /Eight (G7/G8) http://www.g7.utoronto.ca/
- The Group of Twenty (G20) http://www.g20.org
- United Nations Commission on International Trade Law http://www.uncitral.org
- Co-operation Council for the Arab States of the Gulf http://www.gcc-sg.org/
- Organisation of Islamic Conference http://www.oic-oci.org
- Islamic Financial Services Board http://www.ifsb.org
- Accounting and Auditing Organisation for Islamic Financial Institutions http://www.aaoifi.com
- International Islamic Financial Market http://www.iifm.net
- Islamic Development Bank http://www.isdb.org
- Islamic Research and Training Institute http://www.irti.org
- Islamic Corporation for the Insurance of Investment and Export Credit http://www.iciec.com
- Islamic Corporation for the Development of the Private Sector http://www.icd-idb.com
- Arab Fund for Economic and Social Development http://www.arabfund.org/
- Arab Monetary Fund http://www.amf.org.ae/

Saudi Arabia

- Ministry of Economy and Planning http://www.planning.gov.sa/
- Saudi Arabian Agriculture Bank http://www.saab.gov.sa
- General Organisation for Social Insurance http://www.gosi.co.sa/
- National Company for Co-operative Insurance http://www.ncci.com.sa
- Ministry of Justice http://www.moj.gov.sa
- Ministry of Commerce and Industry http://www.commerce.gov.sa
- Saudi Arabian Monetary Agency http://www.sama.gov.sa
- Saudi Arabian Capital Market Authority http://www.cma.org.sa

- **Saudi Arabian Stock Exchange** http://www.tadawul.com.sa
- **Saudi Arabia General Investment Authority** http://www.sagia.org
- **Ministry of Finance** http://www.mof.gov.sa

Miscellaneous

- **Bank Negara Malaysia** http://www.bnm.gov.my
- **Bursa Malaysia** http://www.bursamalaysia.com or http://www.klse.co.my
- **Malaysian Securities Commission** http://www.sc.com.my
- **Labuan Offshore Financial Services Authority** http://www.lofsa.gov.my
- **Bank Islam Malaysia Berhad** http://www.bankislam.com.my
- **Bank Muamalat Malaysia Berhad** http://www.muamalat.com.my
- **Malaysian Association of Islamic Banking Institutions** http://www.aibim.com.my
- **Malaysian Islamic Banking and Finance Institute** http://www.ibfim.com
- **Islamic *Fiqh* Academy** http://www.fiqhacademy.org
- **Standard and Poors** http://www.standardandpoors .com.
- **Bahrain Monetary Agency** http://www.bma.gov.bh
- **Central Bank of Qatar** http://www.qcb.gov.qa
- **Financial Services Authority (UK)** www.fsa.gov.uk/
